

**THE AUDITOR AND FRAUD DETECTION:
AN INTERPRETATION OF THE COMPANIES
ACTS FROM 1844 TO 1989**

BY

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THESIS SUBMITTED FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

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DECLARATION

No portion of the work referred to in this thesis has been submitted in support of an application for another degree or qualification of this or any other University or other Institute of Learning.

DEDICATION

To my mother and sister

whom

I love dearly

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- Lily Liew (Mother) : *I don't agree that you should do a Phd. As a newly qualified accountant, you should start earning lots of money. Also, how will you finance yourself?.....If you must, then go.*
- Sarah Hiew (Sister) : *Mum has sacrificed a lot...I can't understand why you cherish academic learning so much. Aren't you fed up after all these years of studying?.....Work hard in your research.*
- Brian Underdown (Joint Supervisor) : *We'll do our best to help you regarding your financial problems. Meanwhile, accept this loan...*
Because of your close proximity with the research, you need to stand back and re-think through this concept, restructure some of those paragraphs and clarify that idea. And don't let your research suffer by overcommitting yourself on the teaching, even though it can be difficult to draw the line.
- Richard Laughlin (Joint Supervisor) : *Some nice and very interesting material but look critically at the contents: tighten and strengthen the arguments. Always write for the reader...These comments are intended to be creative and constructive.*
If you are not excited about your research, who else will be? Remember to maintain that element of excitement that keeps curiosity and the will to go 'just a little bit further' continually alive. Develop imagination.
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ABSTRACT

The primary focus of this research is on understanding the role of the auditor towards fraud detection. More specifically, it is concerned with ascertaining the statutory audit objectives (relating to fraud detection) from all the relevant Companies Acts since 1844. In addition, it offers some sociological interpretations of the shifts in responsibility and the emergent meanings over time.

The contents of this research are divided into three major parts. The first takes a critical look at the nature of auditing research conducted in this area, paying particular attention to its methodological underpinnings. It concludes that this quantitative knowledge stock does not adequately deal with the epistemological and philosophical concerns primarily because of the dominant scientific and functionalist assumptions upon which such knowledge is based. It is argued to be an inappropriate foundation upon which to build to satisfy the problem focus adopted by this research project. The second part presents a case for and describes the design of a methodological approach called 'EISI' (Epiphanic Interpretive Symbolic Interactionism). It is built on phenomenological symbolic interactionism with hermeneutics as the basis for satisfying the epistemological concerns of this research. The third part applies this 'EISI' model towards an understanding and interpretation of the problematic role of the statutory audit and fraud detection from the viewpoint of the researcher as an auditor.

The conclusions forthcoming from this research are twofold. First, that the 'EISI' model is a general qualitative model for the epistemological concerns here but not the only approach which could fulfil such a claim. Second, the empirical findings indicate that the role of the statutory auditor towards fraud detection is more implicit than explicit. It exposed the defining paradox of contemporary legal culture that its ideology is one of consensus and clarity.

Overall, this research has provided additive contributions in the form of new or improved methodology, evidence, analysis and concepts.

CHAPTER 1

INTRODUCTION

1.0 PRELUDE

"It was early Spring. A shoot apex, after producing leaves is converted into a floral apex to form an umbel inflorescence, complete with the primordia of sepals, petals, stamens and carpels. But only two of the flowers in the umbel proceeded to bloom; one a cactaceae, the other 'the cactaceae'.

Flowers vary greatly (within and without) in structure. The fundamental similarities among flowers of different kinds of plants are however, greater than their differences, since all flowers have the same basic structural plan. But they do exhibit numerous modifications in design which increases their chances of pollination and often reveal evolutionary relationships among plants. The steps in the production of the flower are the result of innumerable evolutionary changes extending over immense periods of time. Flowers give rise to seeds, from whence new plants morphologically eventually arise."

Paul Saw (1991)

1.1 INTRODUCTION

This chapter seeks to open up the thesis into two strands of development. Firstly, it begins with 'a cactaceae' in providing some perspective into the general problem area of fraud (see Figure 1'1). This topical area of interest is seen in terms of a growing crime in the context of recordings, convictions and globalisation which does provide some legitimisation into the current cause for concern and perception by society. Its impact is then (economically, socially, politically) briefly looked into, which is mainly facilitated by the quantum leaps in information technology. The law also attempts to control it through its various delegated self-policing functions incorporating the auditor. The chapter then pauses here by looking into the definition of fraud which is normally taken for granted and yet problematic at the same time.

Secondly 'the cactaceae' provides a rubric of the structural plan and map of this thesis for the reading 'sojourner' (see Figure 1'6).

Nevertheless, in spite of its antiquity, it is hoped that the subsequent sections will put some perspective into the current cause for concern regarding this growing crime.

1.2.2 GROWTH OF RECORDED FRAUD AND CONVICTED FRAUDSTERS

The twentieth century has witnessed a vast expansion of recorded fraud and in the number of offenders who are officially dealt with for fraud. Harding (1990) noted that numerous estimates have been attempted to quantify UK fraud, most of which have placed losses through corporate fraud at between £2 billion and £5 billion annually.

There is a great deal of disagreement among researchers (Gatrell 1980, Sparks 1982, Reiner 1985) over the extent to which rises in recorded crime reflect:

- i 'true' increases in the amount of law breaking;
- ii the growing enthusiasm of state bureaucracies to claim competency at finding 'professional solutions' to crime detection and arrests; and
- iii the increased willingness of victims of all social classes to use the police to deal with their conflicts, albeit that different crimes have different criteria of reporting and recording rates.

There has been an increase not only in the absolute but also in the relative importance of fraud, which was only a mere 0.5% of indictable crime in 1898 but had risen to become 4.6% of indictable crime by 1968 before falling to 3.8% of 'notifiable offences' in 1985 (Levi, 1987). But bearing in mind the caveats of statistical data, it is noteworthy that recorded fraud figures have increased by an average of 4.3% annually since 1980, as set out below in Figure 1.2.

Figure 1.2 : RECORDED FRAUD CASES IN THE 1980s

	1980	1981	1982	1983	1984	1985	1986
Frauds by company directors, etc	30	30	24	45	71	37	25
False accounting	2382	2415	2667	2292	1883	1823	1854
Other fraud	93187	96065	111290	109615	112214	120758	120923

Source : Home Office (1987)

In the absence of any reliable business crime victimisation surveys with which to compare crime statistics, it is therefore not known with any degree of confidence how much of the changes in the official figures for fraud above reflect 'real' changes in fraudulent activity or artefacts of changes in willingness:

- a) to report fraud;
- b) of police to record those frauds that are reported; and/or
- c) to prosecute frauds.

In any event, there would be severe theoretical as well as practical obstacles to such an enterprise. Not only are there no reliable 'body-counts' of unrecorded business crime: with the exception of one US study of securities regulation (Shapiro, 1983), very little is known about what factors influence the non-recording of commercial fraud.

However, not surprisingly, the increases in the number of recorded frauds have been accompanied by rises in the number of convicted offenders over the corresponding period as set out in Figure 1'3 below.

Figure 1'3 : OFFENDERS FOUND GUILTY OF OR CAUTIONED FOR FRAUD

	FRAUD BY COMPANY DIRECTOR	FALSE ACCOUNTING	OTHER FRAUD	BANKRUPTCY OFFENCE
1980	44	765	20636	95
1981	39	818	21200	89
1982	53	715	22826	70
1983	59	734	23200	115
1984	69	687	23149	122
1985	84	734	22468	165
1986	79	693	21191	180

Source : Home Office (1987)

1.2.3 THE GROWTH OF FRAUD INTERNATIONALLY

Internationally, a similar process of growth of recorded fraud and convicted fraudsters has occurred. Research carried out by Levi (1987) showed the following growth rates: Sweden (14%), New Zealand (12%) and West Germany (7%). He noted that in Sweden, recorded fraud other than embezzlement increased from 14,653 cases in 1950 to 91,080 in 1984.

Here, the absence of international research makes it harder to assess the extent to which changes in crime rates may be largely artefacts of changes in law or policing resources. Nevertheless, technological developments intended for ordinary commercial transactions have facilitated fraud: examples include not only computers but also international direct-dialling telephones, telexes, computer-aided despatch systems and facsimile senders which all enable fraudsters to distance themselves geographically from their targets.

1.2.4 PERCEPTIONS OF THE GROWTH OF FRAUD

The rise in recorded fraud has been accompanied by business perceptions of an increase in the risk of fraud.

In a telephone survey of 401 companies of mixed size by Ernst and Whinney's Consensus Research (1985), over half (54%) of respondents stated that they thought that company fraud had increased over the past five years; 28% that it had stayed at the same level; only 1% that it had decreased; with 17% don't know. However, it is important to qualify this by the observation that when asked how serious their own company's fraud problem was, only 4% stated they regarded it as very serious; 5% fairly serious, 30% not very serious, 60% not at all serious and 1% don't know. Fraud problems, according to the survey are something that do happen, but they happen to other people!

Also it is interesting to note that the survey showed that it is the larger companies (turnover > £35 million) who feel most vulnerable to fraud.

In a 1986 Arthur Young questionnaire and interview survey compiled by Levi and Morgan, 8.9% of respondents thought that fraud was very much more common now

than 10 years ago: 58.9% thought it was much more common and only 30.4% the same. Only one person thought that fraud had actually decreased in the last decade. The survey sample comprised executives from security and financial director upwards to company chairman in 74 private sector companies. Because of the small numbers, statistical analysis is of doubtful utility here, but there is some indication of a perception in the growth of fraud.

It is interesting to note that over two-thirds of the respondents thought not only that fraud in general had increased but also that some particular type of fraud had become a special problem in the last decade, such as computer fraud (45.5%), credit/cheque card fraud (25%) and expenses/embezzlement (9.1%).

It is arguable that the respondents do not have an accurate picture of the growth of fraud. Nevertheless, whether perceptions of increased risk are derived from direct experience or from the media and political attention of recent frauds, the results of these surveys indicate that business people do see fraud as a significant general problem in commerce today.

1.3 THE IMPACT OF FRAUD

The scale of losses or injuries does not always determine how we will react to any given type of conduct unless personally involved. If it did, we would pay more attention to industrial and road traffic accidents and less to mugging and intentional homicide as sources of limb damage and trauma. All sorts of things or events can affect the way we view and react to 'social harms'. Apart from the physical, social, emotional and financial impact, among these factors are the perceived intent of the person who is seen as 'causing' the harm and this in turn is related to our perceptions of the 'sort of people' who commit the acts.

1.3.1 COMPUTER FRAUD

Computer fraud occupies a special place in the criminal lexicon. Popularised by massive publicity such as the Equity Funding Corporation of America and used as the medium for unorthodox transactions in films such as War Games and Superman III, the computer occupies a folk devil role in crime as it does in social change generally. For some, particularly the media, it constitutes one of a growing number of new

technocrimes, and there is an obsession about 'hacking' into computer systems and obtaining information or manipulating data (whether for fun or for money). For others, including many respondents to the fraud surveys conducted by Levi and Morgan (1986) and Ernst and Whinney's Consensus Research (1985), computer fraud is little more than old fashioned accounts manipulation by means of computers.

The Audit Commission (1985) stated that *"it is evident that as with the 1981 survey none of the (computer fraud) cases appeared to demonstrate any ingenious application of technological skills: indeed the majority took advantage of inherent weaknesses in particular procedures"* (p2).

The European Community Information Technology Task Force (1984) concluded that fraud comes a close second to fire damage as the most costly form of loss in regard to computer installations in Europe.

The link between crime and increased opportunity has analogies with the relationship between autocrime and the increased ownership of motor cars. Newly available microcomputers and personal computers are gradually increasing as a medium for the perpetration of computer fraud, to supplement the mainframe computer frauds that have dominated the field in the past (ICAEW, 1987).

1.3.2 THE COST OF FRAUD

In spite of the qualifications expressed earlier to the practice of crime statistics, it is an important starting point for social policy to comprehend the effects of fraud upon the social fabric (including the economy); for the question 'how much of a problem is fraud?' must be addressed partially through data on its cost. Criminal statistics though not 'the' way are 'a' way of representing the extent of fraud (or moral values) within a nation.

Estimating the extent of fraud is a task that presents far greater problems than is the case in other types of crime, as evidenced by the patchiness of official statistics on fraud. Thus, although the annual publication of criminal statistics in England and Wales imparts information about losses from burglary, robbery and theft, nothing is communicated regarding losses from fraud. The other major state agency responsible for the control of fraud - the Department of Trade and Industry - similarly neither

publishes nor collects data on its cost. Only the Inland Revenue and Customs and Excise departments provide data on fraud costs in relation to the prosecutions they undertake. The Metropolitan and City of London Police Forces present a very basic amount of data on numbers of cases investigated by their Fraud Squads and, usually, on the amounts of money involved 'at risk'. However, no other Police Forces give as much information as this. Consequently, even at the most basic level of presenting the 'official picture of fraud', criminologists face unusual difficulties.

The 'costs of fraud' do fluctuate but as Figure 1.4 below indicates, they have almost tripled since 1980 and have shot up by 37 times since 1970. These 'costs' according to Collier et al (1988) only represent a small proportion of the true loss since many frauds remain undetected or undisclosed. Even if calculating the 'costs of fraud' currently under investigation is an inaccurate reflection of fraud in any given year, this does not cast doubt upon the fact that fraud consistently recorded on this basis has grown dramatically.

Figure 1.4 : THE AMOUNT OF FRAUD DEALT WITH BY LONDON FRAUD SQUADS

	CITY OF LONDON FRAUD SQUAD	METROPOLITAN POLICE FRAUD SQUAD	COMBINED TOTAL
	£ million	£ million	£ million
1970			36
1980	54	400	454
1981	54	208	262
1982	100	294	394
1983	115	264	379
1984	302	617	919
1985	482	867	1349

Source : Metropolitan and City of London Police (compiled by Levi, 1987)

1.3.3 THE SOCIAL AND POLITICAL IMPACT OF FRAUD

Another important dimension of fraud is more difficult to quantify: its impact upon social values and sense of well-being. Certainly, this has economic and political ramifications. All commerce, and even the acceptability of a national currency, depends upon some degree of trust and confidence. An early example of the consequences of

such a collapse of confidence was the Wall Street Crash of 1929. More recently, during the 1980s, the failure of the Carrian and Pan-Electric corporate groups in Hong Kong, Malaysia and Singapore accompanied by proven allegations of widespread fraud, had disastrous short term effects upon their national economies: stock market values plunged 20% overnight. In April 1986, Singapore and Malaysia share price indices dropped to their 1979 level. Though part of this was due to the collapse of the tin market and the International Tin Council, allegations of fraud there were hotly disputed. Confidence in Malaysian banking institutions was undermined temporarily also by the huge losses among Deposit-Taking Cooperatives in 1986, due partly to a large number of loans advanced to directors and their families without collateral security. During 1986, serious political, as well as commercial, concern was caused in Argentina by an alleged £76 million fraud by its senior management upon the aptly named Banco Alas, which the state prosecutor claimed, involved high ranking politicians and nominees of President Alfonsin.

In the case of fraud affecting financial institutions, or the diversion of funds from governmental or non-governmental aid agencies, the financial effects are measurable but may well extend far beyond the money stolen.

Despite recent scandals in some of Britain's financial markets such as Barlow Clowes, Polly Peck and BCCI, Britain has not yet experienced a long history of loss in market confidence of the magnitude experienced overseas.

It was not until the Guinness share support operations were exposed at the end of 1986 that Britons could not compete with the Americans even in financial scandals. The longer term effects of falls in investor confidence are not readily calculable, yet there is some unknown and perhaps unknowable point at which the escalation of cost begins and may become irreversible. Perhaps this is why any scandal in the City of London generates so much concern.

On the other hand, as Szasz (1986) has argued, the long term political effects of scandal are rather modest, even when they are as well publicised as Watergate.

Media and political concern can lead to heavy pressure to institute prosecutions, such as those in Hong Kong following the £690 million collapse of the Carrian group of companies in 1984, and those in Singapore in 1986, following the collapse of the Pan-

Electric group of companies. One may conclude that the effectiveness of policing is in practice inseparable from its political legitimation.

1.3.4 THE LEGAL PROCESS OF FRAUD CONTROL

Much law relating to fraud has grown up not as the product of a coherent set of intellectual or moral concepts, but piecemeal, in response to particular economic and political crises. It is also scattered about in a multiplicity of statutory and common law provisions such as the Companies Act 1985, Companies Securities (Insider Dealing) Act 1985, Company Directors Disqualification Act 1986, Financial Services Act 1986 and the Insolvency Act 1986.

1.3.5 THE POLICING OF COMMERCIAL FRAUD

When we think of crime, we normally think of the role of the police as the official crime control agency. This is not to deny the existence of a considerable amount of community self-policing, not only in the passive sense of non-reporting of crime, but also in the active sense of dealing with crime informally without police intervention.

In relation to fraud, however, it is important to note that the police have by no means a monopoly of control. Consumer frauds (including restrictive trade practices) may be dealt with by Trading Standards officers or by the Office of Fair Trading; bankruptcy, liquidation, banking, and investment frauds are within the remit of the Department of Trade and Industry; and tax frauds are dealt with by the Inland Revenue or Customs and Excise Department.

1.4 WHAT IS FRAUD?

So far, we have used the term 'fraud' as if everyone knows what constitutes its nature. Yet fraud has never been defined by statute nor has any general agreed definition evolved from the Courts although decisions as to what constituted fraud have arisen in the particular specific circumstances of individual cases.

The 1980 Walker's Oxford Companion to Law suggests that in civil law, fraud is a misrepresentation or contrivance to deceive, commonly by way of a statement knowingly made falsely or without honest belief in its truth, or recklessly, careless

whether it be true or false, and intended to be, and in fact relied on, by the person deceived. In criminal law, fraud is deliberate dishonesty and an element in many crimes.

Levi (1981) defined fraud by identifying three principal sub-types:

- 1) 'pre-planned' frauds, which are businesses set up with the intention from the very beginning of defrauding suppliers;
- 2) 'intermediate' frauds, which occur when people decide to turn a former legitimate business into one which defrauds its suppliers; and
- 3) 'slippery-slope' frauds, which occur when businessmen continue to trade and obtain goods on credit although there is a high risk that unless that business situation improves greatly, they will be unable to pay for the goods.

The 1985 Consultation Document issued by the Department of Trade and Industry to coincide with the introduction of the (then) Financial Services Bill also acknowledged the lack of any statutory definition of 'fraud'. For the purposes of that document (on the auditor's role in the financial services sector) the term was used broadly to cover any act of deceit which would or might harm the interests of a business, clients or customers, or those of its shareholders.

Although adequate for the purposes of that document, this description obviously suffers from a number of deficiencies if fraud is considered in a broader context. It disregards, for example, frauds against the Inland Revenue and Customs and Excise - neither of them presumably being 'clients', 'customers', or 'shareholders'. It also fails to reflect the possibility that reckless (as opposed to intentionally deceitful) conduct may well result in criminal charges being brought against parties, including auditors, limited by default, as 'officers', to the deceitful actions of others.

The Auditing Practices Committee (APC) Auditing Guideline on *The Auditor's Responsibility in Relation to Fraud, Other Irregularities and Errors* published in February 1990 defined fraud as involving the use of deception to obtain an unjust or illegal financial advantage. The Guideline emphasises that the legality of fraud having been committed is only determined following a decision by the Courts.

It appears that the lack of a clear, exhaustive definition of what actually constitutes fraud is one of the reasons why both the law and professional bodies experience such difficulty in providing guidance on responsibility for its detection and in dealing with it if detected. Woolf (1986a) noted that fraud is a concept like, say 'elephant', which is usually recognised when encountered but is not easy to describe with much precision.

It is easily understood why legal advice to the APC has suggested that 'fraud' is a word best avoided by laymen in the course of performing audit functions (including making references on file) since only a Court of law is competent to judge after the event, whether or not it has actually occurred. Those who pre-empt such judgements in gratuitous pre-trial statements may incur charges of defamation.

A survey carried out across a range of legal dictionaries and auditing guidelines from countries with established auditing professions showed a lack of consensus towards the definition of fraud (see Figure 1.5). It is hardly surprising, due to the infinite possible manifestations of fraud. Leigh (1982) noted that most definitions are unsatisfactory because agreed unifying elements are hard to find. Fraud is thus a slippery word not only in nature but also in the search for a generally accepted definition.

Until the Courts are prepared to arrive at a statutory definition of fraud (if that is ever possible), one must probably fall back on the well worn but valid cliché that fraud is one of those things which people find difficult if not impossible to describe but could reasonably identify should they encounter it.

1.5 FRAMEWORK OF THE THESES

There are nine chapters which seek to provide an insight and appreciation on the process of the research conducted here and from embarking upon the actual study. The framework is summarised in Figure 1.6.

Figure 1.5 : TABULATION OF THE MEANINGS OF FRAUD PROVIDED BY VARIOUS LEGAL DICTIONARIES AND INTERNATIONAL AUDITING GUIDELINES

SOURCE OF REFERENCE	INTENTION	DAMAGE		MIS - REPRESENTATION	MATERIALITY	INDUCING RELIANCE ON OTHERS	MISAPPROPRIATION OF ASSETS	KNOWLEDGE	
		GAIN TO SELF	LOSS TO OTHERS					ACTUAL	RECKLESS
A. DICTIONARIES									
Curson's Dictionary of Law	✓		✓	✓		✓		✓	✓
Walker's Oxford Companion to Law	✓			✓		✓		✓	✓
James' Strouds Judicial Dictionary (per Wills J., Ex p Watson 21 QBD 301			✓	✓					
Black's Law Dictionary	✓	✓	✓	✓	✓	✓		✓	✓
Saunders' Words and Phrases Legally Defined				✓					
Friedrichsen's Shorter Oxford Dictionary		✓	✓	✓					✓
B. AUDITING STATEMENTS									
UK's Auditing Guideline No 3.41B	✓			✓					
USA's Statement on Auditing Standards No 53	✓	✓		✓	✓		✓		
Australia's Statement of Auditing Practice No 16	✓			✓					
New Zealand's Auditing Guideline No 9	✓			✓					
Canada's Auditing Recommendation para: - 5300.42 - 5300.55	✓			✓					
South Africa's Statement on Auditing Standards No 6	✓			✓					
UEC's Auditing Statement No 12	✓			✓					
International Auditing Guidance No 11	✓			✓					

This first chapter seeks to introduce and identify the broad area of study, namely the general problem area of fraud. Chapter 2, 'Problem Definition' focuses in on the specific background for the auditor in terms of the research problem, research objectives and the general research approach. This is followed by Chapter 3, 'Summary of Previous Research' which presents a literature review of past empirical studies concerning the auditor's responsibility towards fraud detection.

The specific details of the research design and methodology used are described in Chapter 4, 'Research Methodology'. Chapter 5, 'Data Collection' presents the raw empirical data obtained which is then analysed in Chapter 6 'Mini Stage', Chapter 7 'Micro Stage' and Chapter 8 'Macro Stage'. The final Chapter 9 'Conclusion' highlights the contributions, limitations and concluding philosophical reflections on this research process.

As the arrows show in Figure 1'6, there is much dialectical feedback and feedforward control in the framework. Howard and Sharp (1983) noted that almost by definition, research is not a straightforward process made up of a series of distinct steps each of which is part of a clearly defined sequence. A research project always involves novelty and the researcher has to sometimes return to an earlier step because later experience has shown how the project can be more clearly defined and refined.

1.6 ENVOI

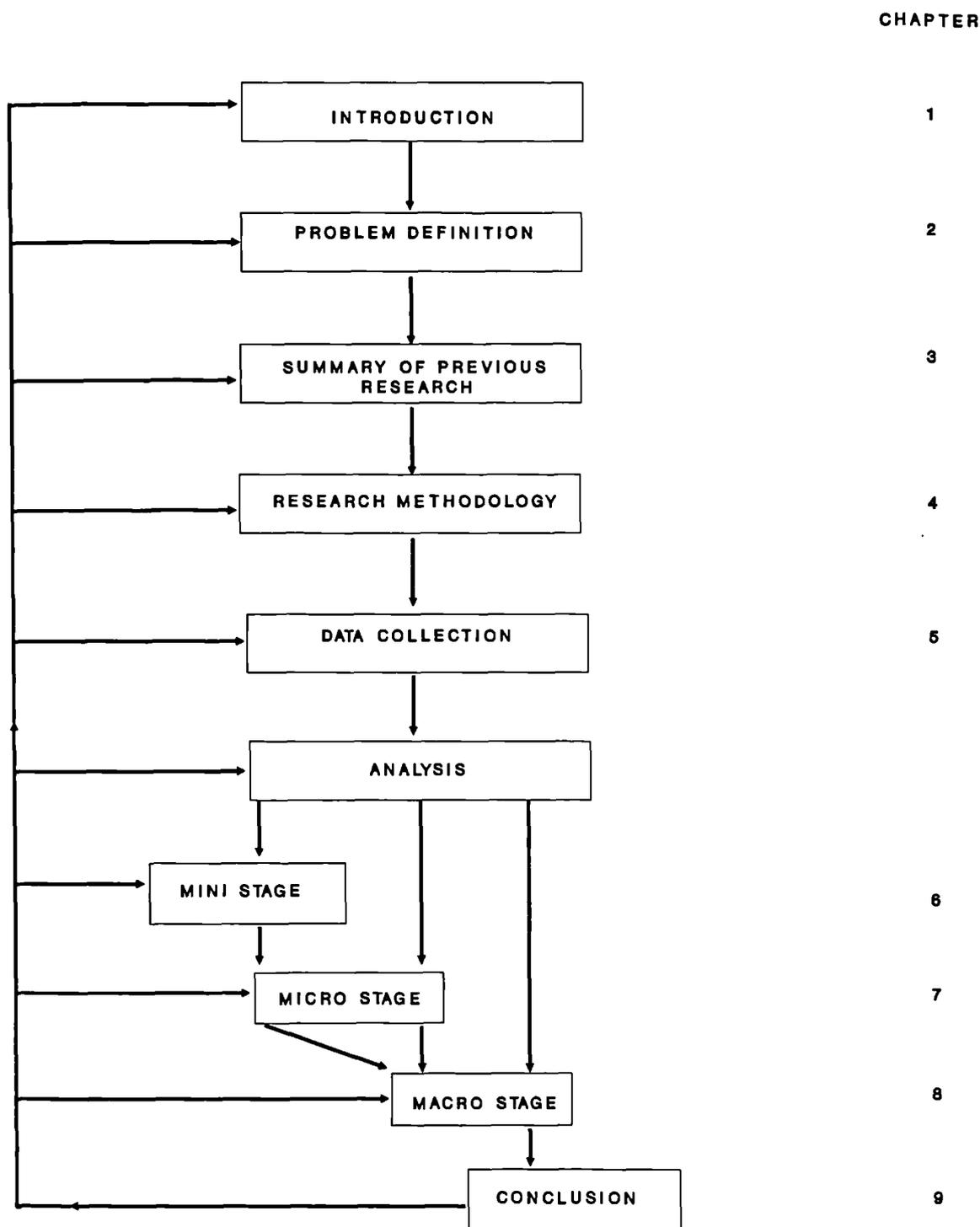
Given that fraud will continue to be viewed and possibly feared as a growing 'animal', how controllable is it in the context of a punitive society?

Post industrial society is characterised by a desperate search on the part of government to find responsible non-governmental bodies to carry out key regulatory functions. A major concern of the Conservative Government in the post Big-Bang era is to establish the framework for a smoothly operating financial market place in which the investor may not only be protected from error of judgement but will be protected from outright acts of fraud.

The question that should be addressed is the level of agreement which exists today amongst the participants in the self-regulatory role played by auditors (on behalf of the

State) as to the responsibility for the detection, prevention and reporting of fraud. This leads us to the next chapter where this issue is being addressed.

Figure 1'6 : OVERVIEW OF THESIS FORMAT



CHAPTER 2

PROBLEM DEFINITION

2.0 PRELUDE

"People are naturally curious about their surroundings. Their bodies need detailed information about the world around them in order that they may adapt smoothly to the demands and processes of living. More important, in human beings, the search for information is carried much further than the bare requirements for existence in order to satisfy our innate desire to understand the world in which we live and move and have our being. It seems natural, therefore, that when we want detailed information about some part of our surroundings, we first take a very close look at it. For such purposes the human eye often proves to be a very inadequate tool, excellent though it may be for the normal needs of existing in our world. This is because the amount of detail which it can reveal to us is very limited.

We are then provided with various receptive mechanisms and technologies to help gather such information, in particular this invention, which I have called 'my secondary eye'. Of all the instruments used by the scientist, this 'secondary eye' is perhaps the one which most aptly symbolises this profession to the non-scientist. It is a tool which finds application in research (both in biological and non-biological fields), in teaching, and in a multitude of industrial and other applications. For such an important symbol of our technology, it is strange that very little is known about its history. It has also been very largely overlooked by the historians of science. Much more research remains to be carried out in the development of this 'secondary eye' be it a polarising or a metallurgical one."

Paul Saw (1991)

2.1 INTRODUCTION

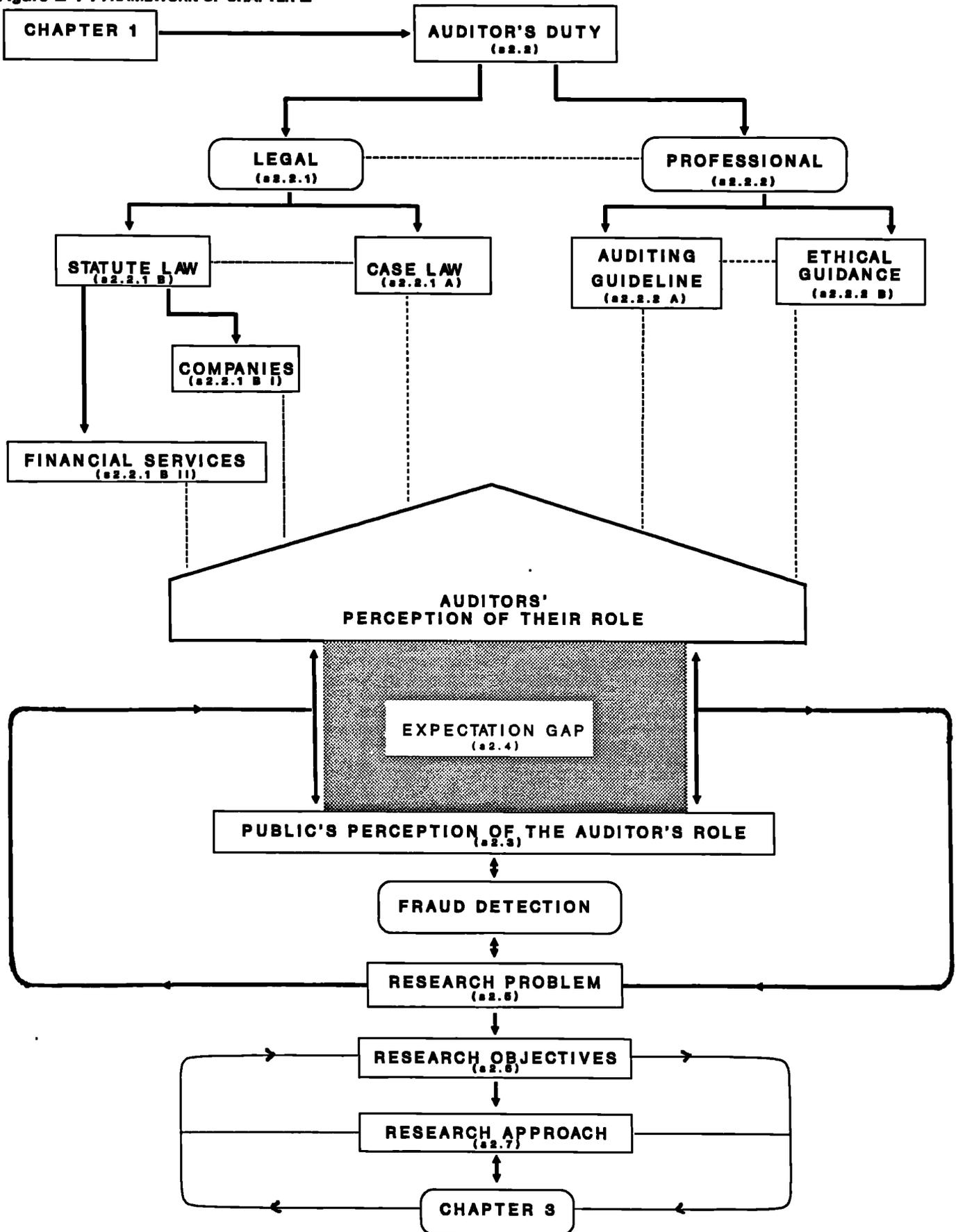
In the previous chapter it was mentioned briefly that the auditor has some indirect policing role in the fraud control problem.

This chapter develops on it by clarifying the current duty of the auditor in terms of the extent to which the audit is carried out to detect, prevent and report fraud. This is basically provided by the law (statute and case law) and professional guidance (auditing and ethical) as shown further in Figure 2.1.

Such a clarification is necessary because it helps the reader to:

- a) ascertain what the present nature and extent of the auditor's responsibilities are in the area of fraud; and

Figure 2.1 : FRAMEWORK OF CHAPTER 2



- b) appreciate subsequently how the historical developments have shaped its present position.

In spite of the increasing responsibility entrusted upon the auditors recently, opinion surveys in this and other countries indicate that concerned segments of the public are generally dissatisfied with the responsibility for fraud acknowledged by the auditors and expect them to assume a greater responsibility. Comer (1985) noted that the management of some companies actually expect the auditors to detect fraud.

It seems that users expect more than they believe they are receiving from the auditors. This has manifested itself in the expectation gap. The gap is at the heart of the criticism of the profession today. Only when this gap is narrowed and reasonable levels of expectation are established as guidelines for professional conduct, will the litigious environment in which the auditors exist be sharply narrowed.

This dilemma provides the scenario for the specific research problem and its importance. The problem states what the researcher will be looking at into his 'telescope'. Its importance addresses the significance of this piece of research.

With the research problem area highlighted, it is necessary to illustrate which aspects in particular the research will be focusing on and this is stated explicitly in the research objectives. How the objectives are to be carried out will then be briefly explained in the general research approach. The approach will however be explained at a much detailed operational level in Chapter 4.

2.2 EXTANT ROLE OF THE AUDITOR TOWARDS FRAUD DETECTION, PREVENTION AND REPORTING

2.2.1 LEGAL RESPONSIBILITIES

A) CASE LAW DIRECTIVES

The discovery of fraud was regarded as the auditor's responsibility but as companies increased in size, the role of auditors changed. This was confirmed in *Re Kingston Cotton Mill Co (1896) 2 Ch 279*. In his summing up, Lord Justice Lopes made certain

remarks concerning the auditor's responsibility for fraud detection which appears to have extended even to today.

"An auditor is not bound to be a detective, or...to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is...not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company...The duties must not be rendered too onerous...Auditors must not be made liable for tracing out ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable."

(2 Ch 288-290)

Case law has been silent on the preventive role but its reporting role is highlighted in *Re London and General Bank (1895) 2 Ch 673* in which it was held that the auditor must fully report the facts to the shareholders when the company's balance sheet has been inadequately prepared. The following remarks are from the judgement of Lord Justice Rigby:

"It was the duty of the auditors to convey indirect and express terms to the members any information which they thought proper to be communicated."

(2 Ch 694)

Lindley L J also added that:

"Information and the means of information are by no means equivalent terms...an auditor who gives shareholders means of information instead of information respecting a company's financial position does so at his peril and runs the very serious risk of being held judicially to have failed to discharge his (reporting) duty."

(2 Ch 684-685)

Since then there have been few landmark cases and the auditor's role outside the financial sector is enshrined in company legislation.

B) STATUTORY REQUIREMENTS

I GENERAL COMPANY LEGISLATION

The auditor's statutory duty is set forth in s235(2) of the Companies Act 1985 (as amended by s9 of the Companies Act 1989), whereby s/he shall report whether in his or her opinion the accounts have been properly prepared in accordance with the Act

and give a true and fair view of the state of affairs of the company. In addition to other statutory duties, the auditor is bound under s237(1) CA85 to undertake such investigations as will enable him or her to form an opinion as to whether proper accounting records have been kept and that the company's financial accounts (eg balance sheet and profit and loss account) are in agreement with them.

Whilst the Companies Act 1985 does not impose any expressed statutory duty on an auditor to detect or prevent fraud, the duty to report as to whether in his or her opinion the accounts give a true and fair view of the state of affairs of the company will involve certain investigations and checks which may themselves give rise to a suspicion which may in turn make it impossible for the auditor to give an unqualified report. In performing the statutory audit, the auditor has [under s389(A)(1) Companies Act 1985] a right of access at all times to the company's books, accounts and vouchers, and is entitled to require from the company's officers such information and explanations as s/he thinks necessary for the performance of his or her duties. It would appear that if suspicions are aroused, then there appears to be some duty on the auditor to detect fraud especially one which is serious or material enough to impinge on the true and fair view of the company's accounts.

Just as there is no express statutory duty on an auditor to detect or prevent fraud, equally there is no express statutory duty on an auditor to report the existence of a fraud in the past or the present client's accounts. However, once fraud has been discovered by the auditor, it would invariably be incumbent upon the auditor to refer to such fraud in his or her report to members. The basis is that such fraud would be sufficiently material as to affect the auditor's opinion as to the accounts disclosing a true and fair view of the state of affairs of the company.

In the event that the accounts themselves sufficiently take into account the fraud in question whereby the auditor would be able to form an opinion that the accounts still disclosed a true and fair view of the state of affairs of the company, explicit reference to the fraud in reporting to members would probably not be necessary and lie with the auditor's discretion.

Whilst the foregoing paragraphs appear to represent the current state of the law, a strong argument exists to support the view that an auditor in the foregoing circumstances should nevertheless specifically refer to a fraud in reporting to members

albeit that the accounts per se sufficiently take into account the fraud in strict accounting terms. In these circumstances, the Auditing Practices Board may wish to consider drafting specific guidelines to deal with the above issue.

With regard to the auditor reporting suspected fraud to a third party, such as a supervisory body or the police, there exists no duty to do so at common law save when the auditor knows or suspects his client to have committed treason.

However, there has been increasing pressure on the accounting profession to review its responsibilities, particularly in the financial sector. Legislation in this sector has extended the auditor's responsibility beyond the Companies Acts 1985 and 1989.

II SPECIFIC FINANCIAL SERVICES LEGISLATION

Tweedie (1987) in discussing the functioning of the audit report as an early warning/burglar alarm system noted that, it is difficult for lay people to understand how a company can suffer serious financial difficulties, or even collapse, shortly after having received an unqualified opinion.

In the area of investment businesses outside the scope of company legislation, such as partnerships and sole traders, the auditor's role in reporting fraud to the appropriate authorities has been considerably enlarged by legislation in the financial sector. Ernst and Whinney (1987) noted that the scope of audit for such authorised businesses goes beyond that of the normal Companies Act audit.

Based on Professor Gower's *Review of Investor Protection Report (1984)* and the various financial scandals surrounding that period, the Government has introduced three new Acts - the Financial Services Act (1986), the Building Societies Act (1986) and the Banking Act (1987), all of which relate to investor protection.

Tweedie (1991) noted that the management of organisations governed by these three Acts will only be authorised to conduct business in the appropriate financial sector if the organisations:

- a) keep proper accounting records;

- b) **have adequate systems of internal controls, (with the exception of organisations covered by the Financial Services Act - many of these organisations are too small to have internal control systems), and have appropriate reporting and inspection systems to enable them to determine whether their control systems are working; and**

- c) **conduct their business in a prudent manner.**

Hence, the auditor is not only to report that the financial statements show a true and fair view, but explicitly to report whether proper accounting records are kept and, in the case of all except those organisations covered by the Financial Services Act, that the internal control system is adequate. Additionally, under all three Acts the auditor may report to the supervisory authority (the regulator of a particular industry) if he is satisfied that it is expedient to do so in order to protect the interests/investments of shareholders or depositors, or if the auditor is requested to do so by the regulator on it being so satisfied. This entitlement is notwithstanding any obligation of confidence incumbent upon the auditor and whether or not to do so would be contrary to the interests of the organisation itself. In the financial sector of the economy, it appears that the auditor is emerging as an agent of the regulatory body.

Brown (1988) noted that the auditor will not be in breach of any duty to which he may otherwise be subject if he communicates in good faith to the relevant regulatory body, whether at its request or on his own initiative, any information or opinion on a matter of which he has become aware in his capacity as auditor and which is relevant to the regulatory body's functions under the Act.

The auditor would be expected to exercise his right to report to the regulator in three types of situation summarised by Tweedie (1991) as follows:

- 1) **In the extreme situation where there was evidence of imminent financial collapse and where it would be obvious to an auditor that he must inform the regulator of the position if the client was unwilling or unable to do so, even if it was only to enable the regulator to organise a rescue or mitigate damage.**

- 2) **Where there has been an occurrence:**
- a) **which in the opinion of the auditor gives rise to actual or potential risk which is or may be material to the security of investments or interests of shareholders and depositors (including effects on confidence in the organisation and in its financial stability); and**
 - b) **of which the regulator should be informed but which is not covered by regular monitoring returns (ie statistical and financial information regularly supplied by the organisation to the regulator); and**
 - c) **of which the Board of Directors declines to inform the regulator.**
- 3) **Where there has been an occurrence which causes the auditor no longer to have confidence in the competence and integrity of directors and senior management to direct and manage the organisation in a way which protects the investments and interests of shareholders and depositors or to give a true representation of the position of the organisation to the regulator.**

It has been deemed appropriate for the auditor to report to the regulator without the knowledge of the client in situation 3 outlined above. Even then, situation 3 gives the auditor the right, not the duty to report suspected cases of management fraud.

The reason for allowing judgement rather than imposing an obligation is that 'suspected' fraud covers a wide range of uncertainty as to whether an offence has in fact been committed and by whom it has been committed. Where fraud is suspected, there will always be a threshold of certainty below which it would be unreasonable to expect anyone to report their suspicions. The Davison Report (1985) commented that it is impossible to define at what point suspicion of fraud may be regarded as reasonably founded, and there will also be borderline cases where reasonable observers might draw differing conclusions from the same evidence.

If the auditor has a right to report his suspicion, he can use his judgement as to the occasions on which they are sufficiently well founded to justify making a report. If he has a duty to report there would almost certainly be a tendency for auditors to report their suspicion even when they were not well founded - with the consequences of

fractured relationships between auditors and clients and the overloading of the supervisory authorities.

Even with the right to report, the auditor could still be at risk where he fails to report. The auditor remains vulnerable to claims by 'investors' under the Acts for failure to act in appropriate cases to protect their interests. Morgan (1989) concluded that regulators have immunity under the Act; auditors do not. There is no protection for the auditor who fails to report a matter which it was reasonable for him to have been aware of (Chandler, 1987)! Consequently under the present legislation, there is still a problem that over-reporting may take place. Similarly, while the auditor is only expected to report material problems, there is always the concern that a small fraud may just be the precursor to a larger one.

Woolf (1987) raised the question of how far should audit reporting duties be extended. Auditors cannot be expected to be aware of all circumstances which might have led them to exercise their right to report. Similarly, it is accepted by regulators that the auditor does not have the benefit of hindsight when judging whether or not fraud has occurred. Nevertheless, the auditor will have to satisfy himself that his decision not to report will stand up to examination at a future date on the basis of what he knew at the time, what he should have known in the course of his work, what he should have concluded and what he should have done.

Having seen the reporting role legally extended in the financial services sector, where does this leave the auditor of a company or enterprise outside the financial services sector? This leads on to the next section on professional guidance.

2.2.2 PROFESSIONAL RESPONSIBILITIES

While legislation is dictating the role of the auditor, views have also been changing in the profession on the auditor's general responsibility for detecting and reporting fraud. Professional responsibilities for the auditor on fraud come from two sources - in auditing and in ethical pronouncements.

A) AUDITING GUIDANCE

The UK's Auditing Practices Committee (then) has issued a guideline on *The Auditors Responsibility in Relation to Fraud, Other Irregularities and Errors* in February 1990. It lays down quite clearly the profession's view of the responsibilities of management and auditor. The profession, not surprisingly, agrees with the Government that the primary responsibility for the prevention and detection of fraud rests with management. In addition to its business responsibilities, management has the fiduciary roles of safeguarding assets and preparing accounts which give a true and fair view. These duties arise since management is regarded at law and also in social history (Glautier and Underdown, 1991) as acting in a stewardship capacity concerning the property under its control and is required to keep proper accounting records and to prepare accounts which show a true and fair view.

Management should exercise their responsibility primarily by the institution and operation of an appropriate system of internal controls. The auditor should, where necessary, remind management of their responsibility to maintain an adequate system of internal controls with a view to detecting/preventing fraud, other irregularities and errors [in the *Audit Engagement Letter* (APC, 1985) or by other communication]. The auditor may ask management for details of any fraud which they know of.

There are other statutory measures relating to management responsibilities. For instance, the aiding and abetting of false accounting is prohibited under s17 and 18 of the Theft Act 1968 and a company's directors have the responsibility to ensure the company does not engage in wrongful trading under the Insolvency Act of 1986.

As it is deemed that an officer of a company would be guilty of an offence where s/he knowingly or recklessly made a statement to the company's auditor which was misleading, false or deceptive in a material particular [s389 A(2) Companies Act 1985] the auditor is entitled to accept representations as truthful in the absence of any indication to the contrary and provided these are consistent with other corroborative audit evidence obtained.

The auditor's duties do not require him specifically to search for fraud unless required by statute or of the specific terms of his engagement. But the auditor's responsibility towards fraud would be limited to designing and evaluating his work with a view to

detecting such frauds which might impair the truth and fairness of the view given by the financial statements. In doing this the auditor would have to take into account the distinction between the risks of manipulation of financial statements and accounting records and the risks of misappropriation of assets.

The engagement letter would indicate that the auditor would endeavour to plan his audit so that he would have a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud but that the examination should not be relied upon to disclose all frauds which may exist. To obtain sufficient appropriate audit evidence to afford a basis of support for his audit opinion, the auditor should seek reasonable assurance through the application of procedures that comply with Auditing Standards that material fraud which would impair a true and fair view being given by the financial statements have not occurred or if they have occurred they have been either corrected or properly reflected in the financial statements.

If in the course of the audit, the auditor's suspicions are aroused, professional auditing guidance demands that he should not overlook the problem or leave it alone. He must investigate the matter until his anxieties are allayed or report appropriately. If fraud has been detected, the auditor may consider it appropriate to make recommendations of good practice in order to assist in the prevention of further occurrences of the fraud.

The guideline states that the auditor should report to senior management of an enterprise on any fraud and should report material fraud to shareholders by qualifying his opinion. The auditor would however, have no need to qualify his opinion if the financial statements give a true and fair view despite the occurrence of fraud. Nevertheless, the auditor may be expected to qualify his report under other reporting responsibilities where (such as required by company law) he concluded proper accounting records had not been maintained or where he failed to obtain all necessary information and explanations.

In extreme circumstances where the auditor was prevented from executing his work to such an extent that he was unable to report on the financial statements, the auditor is advised to resign. In the case of a company, the auditor's reasons for his resignation would be sent to the shareholders and everyone else entitled to receive the company's accounts.

Regarding reports to third parties, the guideline accepts that, in certain circumstances (legal duty and public duty), the auditor would not be bound by his duty of confidentiality which would normally debar him from reporting any matters to third parties without his client's permission. For example, the auditor may be legally bound to make disclosure of the commission of a criminal offence if ordered to do so by a Court or by a government officer empowered to request such information.

In all other cases, however, the auditor is advised to consider his reporting responsibilities and guidance issued by his professional body. On occasions, he may have to obtain legal advice as to whether he can disregard his duty of confidentiality and disclose the information to the appropriate authorities on the basis of public interest. Such a public duty arises where an auditor possesses information of any intended criminal offence, or a serious criminal offence, civil wrong, or breach of statutory duty, even if it has already been committed, if it is likely to cause serious harm to an individual or if it may affect a large number of people.

B) ETHICAL GUIDANCE

It has been left to a separate statement 1.306 *Professional conduct in relation to defaults or unlawful acts* (first issued by the Council of the ICAEW December 1980, revised January 1988) in consultation with the Councils of the British accountancy bodies to their members to give the definitive view on reporting suspected fraud, especially to third parties. The relevant provisions are as follows.

An auditor who acquires knowledge indicating that a client or an officer or employee of the client may have been guilty of some default or unlawful act (eg fraud) should normally raise the matter with the management of the client at an appropriate level. If his concerns are not satisfactorily resolved, he should consider reporting the matter to non-executive directors or to the client's audit committee where these exist. Where this is not possible or fails to resolve the matter, the auditor may wish to consider making a report to a third party.

The revised statement seeks to encourage auditors to report. The accountancy profession, however, are bound by the current state of the law and believe it would be wrong to encourage their member auditors to act in a manner which could leave them vulnerable to legal action by an aggrieved party and have therefore relied heavily on

legal advice in preparing the revised statement. This statement states that there are certain circumstances which in spite of the contractual and confidentiality position, an auditor is obliged to disclose (eg treason, which they are legally obliged to disclose). Even if not obliged to disclose, he may be free to do so if he wishes and may conclude that it is right to disclose in the public interest or for his own protection or where expressly provided by statute (eg Drug Trafficking Offences Act 1986) or authorised by client expressly or by implication.

While 'the public interest' is a concept recognised by the Courts, no legal definition of 'public interest' has ever been given. Consequently the state of the law in the UK leaves the auditor with a difficult decision as to whether matters which he may wish to disclose are subject to a duty of confidentiality or whether that duty has ceased because disclosure is justified in the public interest. It is, in any case, clear that exceptions to the duty of confidentiality cover only disclosure to "*one who has a proper interest to receive the information*" [per Denning L J in *Initial Services V Putterill (1968) 1QB 396* - presumably the appropriate Government departments (Police, DTI) or regulators (SIB, Stock Exchange)].

Under the ethical guidance, matters that the auditor would have to take into account when considering whether or not disclosure would be justified in the public interest include:

- the relative size of the amounts involved and the extent of the likely financial damage;
- whether members of the public are likely to be affected;
- the possibility or likelihood of repetition;
- the reasons for the client's unwillingness to disclose the matters to the proper authority himself;
- the gravity of the matter; and
- any legal advice obtained.

Regarding the auditor's own protection, an auditor may disclose to the proper authorities information concerning his client where the auditor's own interest required disclosure of that information:

- a) to enable the auditor to defend himself against a criminal charge or to clear himself of suspicion; or
- b) to resist proceedings for a penalty in respect of a taxation offence, for example in a case where it is suggested that he assisted or induced his client to make or deliver incorrect returns or accounts; or
- c) to resist a legal action brought against him by his client or some third person; or
- d) to enable the auditor to defend himself against disciplinary proceedings or criticism of him which is the subject of enquiry under the joint disciplinary scheme; or
- e) to enable the auditor to sue for his fees. .

Legal advice to the UK accounting profession indicates that if an auditor forms a subsequent view that unlawful acts or defaults have occurred and has already communicated the relevant facts to a person who has a legitimate interest in receiving them, he will normally enjoy qualified privilege from liability for defamation. Unless malice is proved against the auditor, that privilege will amount to a complete defence even if the facts should prove to be wrong. Obviously, each case has to be considered on its own merits and any auditor who is in doubt as to the courses which are properly open to him is advised to consult his lawyers about his rights and duties. Clearly any public announcement or communication direct to shareholders, even if justified by the particular circumstances of the case could well cause serious damage to the company or to individuals and consequently such a step should not normally be undertaken without taking legal advice.

2.3 PUBLIC'S PERCEPTION OF THE AUDITOR'S ROLE

The interest by the public in the auditor's responsibility for fraud is not new, but has been given greater emphasis recently because of a number of well publicised financial

scandals, resulting in the question echoed by Foster *"Where were the auditors?"* (1987, p114).

The 1986 *Report of the Working Party on the Future of the Audit* (chaired by M Patient, ICAEW hereinafter the 'Patient Report') concluded that there is evidence of a gap between the public's perception of the role of the audit and auditors' perception of that role. Among the various areas highlighted by this gap is that of fraud detection. The gap may also be one of the reasons for the apparent increase in litigation against auditors especially in cases of alleged audit failures.

The Auditing Practices Committee, as a priority task, has set up as noted by Springett (1988) a Task Force to consider the extent of the 'expectation gap' and how it can be bridged. This expression ('expectation gap') is used to describe the divergence between what the auditing profession sees its role in practice, in the context of legal and professional responsibilities and on a broader range of duties which the public would wish the auditor to fulfil.

Some of this divergence arises because of auditors' difficulty in precisely identifying for whom they carry out their work. Initially, the audit could have been narrowly defined as exclusively for the benefit of the shareholders of the company as an independent assurance that the financial statements were not misleading. Greater assurance is now requested not only because of the increased risks in business, but because many third party users of financial statements rely on them as their sole source of independent financial information about the company.

Though the population of accounts users may have increased greatly - especially following the requirement that limited companies file audited accounts with the Companies Registration Office, under the Companies (Amendment) Act 1986, these users do not necessarily always grasp the underlying concepts on which financial statements are based. They may, for example query the competence or independence of the auditor where a business is wound up with losses on the realisation of assets and significant unaccrued liabilities following the cessation of trade because of their inability to adequately comprehend the concept of going concern. Mathematically, financial statements should be exact, precise and without error. The assets should equal the liabilities and the number should tally. But that is where the precision ends. Unfortunately in the mind of the ordinary reader or user, the precision has not ended

there. It carries over to what those numbers 'represent' or what the user believes they represent. The figures are to a large extent, a reflection of judgements and accounting conventions. The specific incorporation with the Companies Act 1985 Schedules 4 and 4A of basic accounting principles and rules may, in the long term be of help in this regard.

Walsh (1988) commented that sections of Government and of the public look upon the auditor not as a business adviser, carrying out his statutory function and giving helpful financial advice to his client, but rather as a policeman actively seeking out and detecting fraud. This analogy fails to acknowledge that a detective's investigation only commences where there are suspicious circumstances, and that the detection of fraud is far more difficult than the detection of error, in that a fraud usually encompasses acts intended to conceal its existence and subsequent discovery. Motyl (1991) noted that a study carried out by the independent research consultancy City Research Group on the corporate audit and accountancy market in the UK showed that 62% of the companies agreed that an auditor's duty should include fraud detection.

Davidson (1975) noted that though the auditor may be relieved from legal sanctions by the defence that he acted in accordance with professional standards, he is not relieved of the risk of society seeking to take action against him. The auditing litigation explosion that has taken place in recent years would seem to lend credence to Davidson's statement.

2.4 NATURE OF THE EXPECTATION GAP

As can be seen from the diversity of views about the audit function above, there exists a legitimate expectation gap, which Adams (1988) has associated it with the audit catch-phrase of the 1980s. In general terms, it can be described as the gap that exists between what the public (especially users of financial statements) believe auditors do (or ought to do) and what the auditors actually do. The concept is certainly not new though the term 'expectation gap' was not used in 1885 in the ICAEW president's speech to the Students' Society of London.

It appears to me to be the rooted opinion of an enlightened public and of the ignorant portion of the press that an auditor must have failed in his duty if a fraud has been effected, whether it is eventually discovered or not...The result of this ignorance has been that in cases where such frauds have been discovered, an immediate outcry is raised for the dismissal of the auditor...In my experience I have found men of ordinary

business ability holding the most ridiculous opinions as to the power of a professional accountant to detect fraud and error."

Griffiths (1885), p27

Humphrey (1991) commented that there are doubts and uncertainties being expressed about the role of auditing and what is expected of auditors. In particular, the professional accountancy press provides witness to an increased concern with the notion of an audit expectation gap, a debate fuelled intermittently by major financial scandals (such as Barlow Clowes, Ferranti and BCCI) which place the audit function under the public microscope.

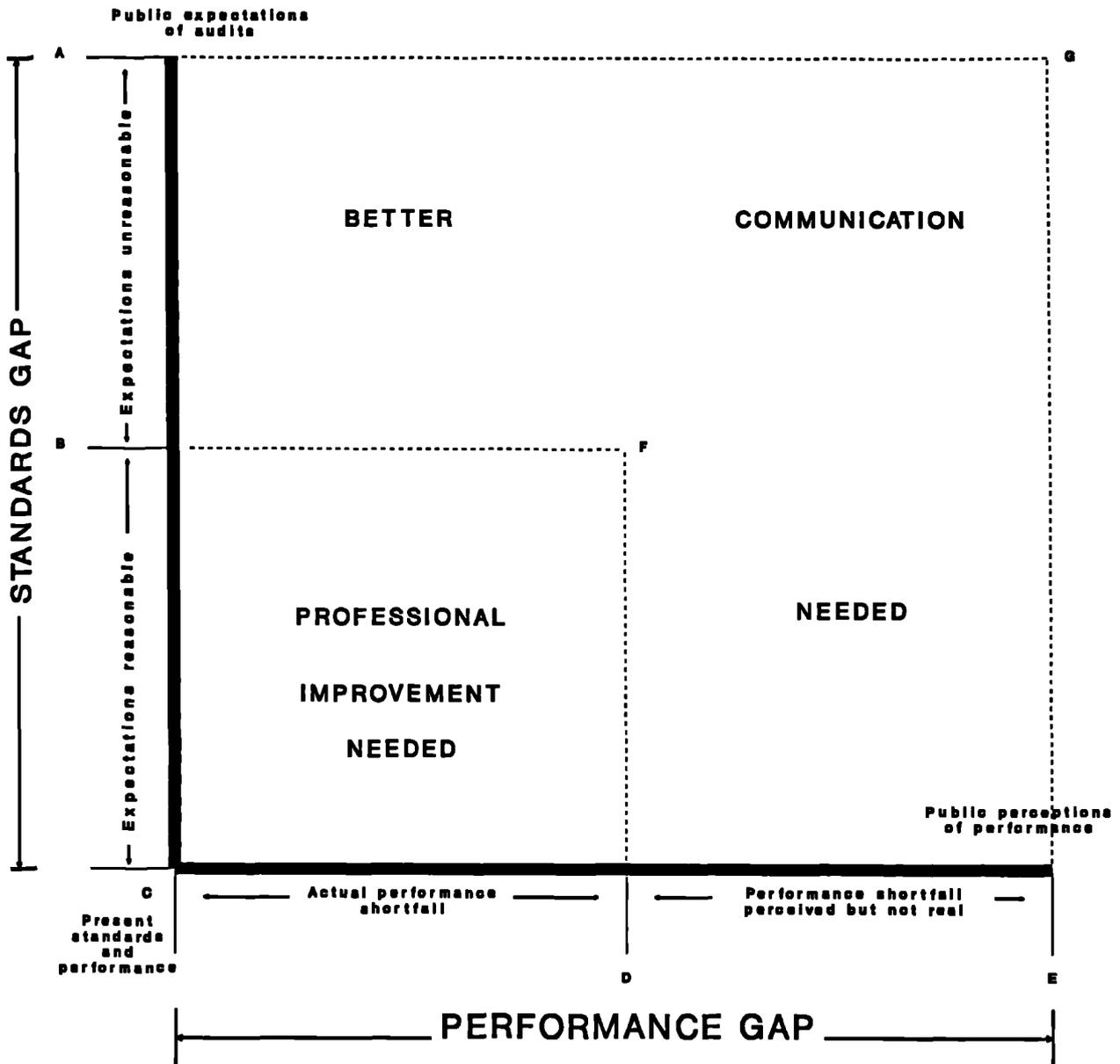
To assist the reader's understanding of possible reasons for the existence of an expectation gap, a diagram (Figure 2'2) has been drawn up to illustrate its components.

The model is developed from the ideas of the Macdonald Commission (1988) who attempted to illustrate the components on a linear scale only. An attempt has been made here to improve on the Commission's model by portraying the interactions between the components on a two dimensional scale. This is explained as follows.

The expectation gap generally stems from differing expectation levels as to both the quality of the standards of the auditing profession and its performance.

Point *A* represents the 'highest' public expectations from audits whereas point *E* depicts the public perceptions of what is 'actually' obtained from audits. Point *C* represents what is called for by present auditing standards by way of auditor performance and quality of financial information reported. The y-axis (line segment *A* to *C*) represents possible public expectations that go beyond what is called for by existing standards (legal and professional) governing auditor performance and the content and quality of financial reporting. This dimension is labelled the 'standards gap'. The x-axis (line segment *C* to *E*) represents possible public perceptions of auditor performance or audited financial information falling short of what is called for by the profession's existing standards. This segment is labelled the 'performance gap'. The space between the axes represents the various combinations of the components of the expectation gap contingent on the two dimensional variables. Cooke (1990) argues further that post-Caparo a liability gap exists, where the public does not know to whom an auditor is legally responsible.

Figure 2'2 : COMPONENTS OF THE EXPECTATION GAP



The emphasis in this diagram is on public expectations of standards and public perceptions of performance. Those expectations may or may not be reasonable and those perceptions may or may not be realistic. It should also be pointed out that empirically it is difficult to measure these variables precisely. But it can be appreciated that an unrealistic expectation that is disappointed, or an erroneous perception of performance can be just as damaging to the public's trust in auditors and audited information as real shortcomings in auditing standards or performance. It is, nevertheless, important to appreciate the realism of public expectations and perceptions when the profession seeks remedies to the expectation gap. According to Jenkins (1990) the disappointments and misunderstandings must be actively addressed in the profession to maintain confidence in the value and use of accounts. If the public has reasonable expectations not met by existing professional standards (line segment *BC*) or the profession's performance falls short of legal and professional requirements (line segment *CD*) or a combination of both, then it can and should act to improve standards or improve performance. On the other hand, if the problem is that the public's expectations are unreasonable (line segment *AB*) or its perceptions of performance are unrealistic (line segment *DE*) or both, then the logical course is to attempt to improve public understanding. Should that not be feasible, the profession must be prepared to cope with the consequences such as that noted by Gwilliam (1987a) where users may bring political pressure in shifting the level of auditor responsibility performance closer to their own perceptions of what it should be (ie enlarging quadrant *BCDF*). Macaskill (1988) reiterated that auditors need to look at their act and make sure they are doing what the public wants.

The Patient Report concluded that the profession should be more positive in addressing the expectation gap and anticipate and lead changes in the auditor's responsibilities, where it is appropriate to do so. It added that research is necessary to establish current and future expectations of the audit, so as to ensure that as far as possible, the type of service supplied by auditors as to the audit is consistent with the type of service demanded and by implication, valued by other parties to the audit.

2.5 RESEARCH PROBLEM HIGHLIGHTED AND ITS SIGNIFICANCE

It is often said that one should review the past in order to understand better what is happening at present and to obtain clues regarding likely future developments. This is an idea which will be found in chapter 3 to be unattractive to contemporary auditing

researchers in the area of fraud, even more surprisingly by accountants too, in view of their traditional pre-occupation with historical data both as a basis for assessing performance and as a starting point when devising plans for the future. The current dominant view can be seen to reside within the perspective that Burrell and Morgan (1985) call 'functionalism'. It approaches a subject from an objectivist pragmatic view which has restricted the focus of research to the technical aspects only.

Edwards (1980) emphasised that the historical researcher is on firm grounds when claiming that his work should help towards an improved understanding since many of the conventions and practices presently employed are explicable only in terms of their development. Beyond this it would seem reasonable to suggest that those taking decisions affecting the future direction and prestige of the auditing profession might usefully devote more attention to historical enquiry.

As was shown in Figure 2.2, three quarters of the quadrant *ACEG* related to better communication to improve the expectation gap. Has the public misinterpreted the auditor's duties as laid down by statute, case law and professional guidance? Beck (1973) found considerable support for the view that the audit is designed to give assurance on the efficiency of management and the financial soundness of the company. Or is it the auditors who have misinterpreted their stated duties? Lee (1970) argued that if auditors do not fully comprehend their auditing role in society, then how could non accountants be expected to understand it. Or is it a combination of the misinterpretation by both parties? Such questions tend to gloss over the more fundamental issue. If the essence of it is 'misinterpretation', then perhaps the real problem lies in the determinacy or indeterminacy of the wording in the documents rather than solely on the parties themselves. According to Neebes and Roost (1987), the wording of the audit report will continue to mean different things to different people. It has generally been taken for granted that the blame lies in with the public and/or the auditors but not the regulative documents per se. Despite the Auditing Practices Committee's issued guidance on more than 50 topics, the expectation gap appears to grow rather than diminish (Cooke, 1990). To assert the latter view, one needs to take one step back to explore on the complexities and dynamics of content analysis and its subsequent possible interpretations. Part of the problem lies in the implicit assumption that there exists one real absolute interpretation of the audit function.

This research seeks also to explore the hypothesis that the wording of the statutory documents themselves are a major contribution to the expectation gap. As it has never been questioned before, it is a concern of this research to address this issue. For if this is the key default, then perhaps we have been 'boxing shadows' in the past and would now need to put on a 'new pair of spectacles' to identify the real problem area. Moizer (1991) noted that it is of interest why despite the successive committees and inquiries which have investigated the gap and wide recommendations for its reduction, the problem has not been resolved.

Following from all this, it is argued that there is a case for a historical analysis which provides not only powerful insights into the past but also, with the historical analysis and understanding, provide some of the possible explanations towards the expectation gap. As was pointed out by Laughlin (1987), historical analysis is not some value free activity, but is undertaken with a particular purpose in mind, to analyse points of progress, to discern the mechanisms leading to their (past, present and future) emergence. Such a methodology will involve a combination of subjective and objective dimensions. On the basis of research and publications in the auditing area on fraud detection, the researcher is much aware of how little we know about (a) the interpretation of the documents that have shaped the auditor's role and (b) the interpretation of the factors that have moulded the auditor's role. Such an insight is a necessary pre-requisite step in dealing with the expectation gap since it can provide some of the explanations towards the emergence of that gap and the apparently tangential trajectory of the auditor's role towards fraud detection. Even though the previous sections stated a rather minor role for the auditor in the discovery of fraud currently, this has not always been so in the past. As Willingham (1975) notes:

"Perhaps the discussion of the auditor's responsibility for the detection of fraud has not yet diminished because it was a stated audit objective for over 400 years and was removed as an objective by the profession rather than by change in the demand of clients of accounting firms. A solicitous consuming public would reinstate it."

(p19)

In fact, at the heart of the expectations gap, there is none more contentious point than that of fraud detection. It is thus an important context on which to focus. Historical analysis thus becomes important because it will also help to note the shifts in emphasis and provide some explanations towards it.

The importance of it all may be echoed with Gwilliam and Macve (1988) who perceived that a key element in auditing research will be further study into the history of the development of the auditing profession (including its evolving duties). The historical study is to gain a clearer understanding of some of the processes and circumstances that have shaped its past and present role and how these are changing and may continue to change.

For the purposes of this research, the medium chosen to explore the issues highlighted above will be in the realm of statute law, in particular the Companies Acts. Statute law provides the highest level of responsibility that can ever be imposed on the auditor, not only because of its authoritativeness but also due to the punitive measures emerging from prosecutions; which can include imprisonment. Case law and other pronouncements would also be relevant documents to look into but due to the extensive time span covered (150 years), the massive amounts of statutory material available and the constraints of time and cost, it is only feasible to limit the scope of this study primarily to the Companies Acts.

2.6 RESEARCH OBJECTIVES

The purpose of this research is:

- a) to ascertain historically the statutory audit objectives (relating to fraud detection) over time, commencing from 1844 (first Companies Act) which led to the genesis and impetus of the compulsory audit today;
- b) to study the differing modes of statutory interpretation;
- c) to obtain some understanding from the viewpoint of the researcher as an auditor of the shifts in responsibility of the auditor's role towards fraud detection from its being the primary object of the audit in 1844 to its steady erosion over this century.

2.7 RESEARCH APPROACH

In conjunction with the objectives, it is proposed:

- a) to review the Companies Acts from 1844 to 1989, to identify the relevant statutory provisions on the auditor's statutory duties.
- b) to set up various statutory interpretive modes and apply them to the statutory provisions for further analysis and insight.
- c) to obtain some interpretive explanations from the viewpoint of the researcher as an auditor to the various mechanisms and their interrelationships which have shaped the auditor's statutory duties over time.

2.8 ENVOI

It appears that the auditor's role regarding fraud in the UK has been undergoing some major revisions lately, especially in the area of reporting. Professional guidance does not yet go as far as requiring auditors automatically to report any fraud perpetrated by directors to the authorities. It is doubtful, however, whether once experience has been obtained from reporting on fraud in the financial sector, the auditor will be able to argue that he should similarly have the legal right to report on cases of management fraud in other sectors of the economy. The debate on the UK auditor's responsibilities for detecting, preventing and reporting fraud is clearly far from over, presumably for as long as the expectation gap continues to exist.

This research has three important features for the purposes of the present study:

- 1) the objectives developed are based upon a genuine topical auditing issue - namely fraud detection;
- 2) the analysis of the data focuses upon the legal knowledge that is demanded in any statutory audit; and
- 3) the offering of an explanation of that evolving statutory role from 1844 to provide an understanding of and linkage with the present role.

Overall, this research seeks to gain a deeper understanding on the interpretation of statute and the changing statutory auditor's role over time in relation to the:

- a) past - in terms of the process and circumstances that have shaped the present objectives**
- b) present- how those objectives are changing**
- c) future - the possible ways that they may continue to change**

Such a methodology of historical analysis is seen to be a unique contribution to the existing knowledge of auditing research. We now need to direct our attention to looking at past research studies to justify the previous statement.

CHAPTER 3

SUMMARY OF PREVIOUS RESEARCH

3.0 PRELUDE

"Tell us again, Master, how it was in the beginning."

"In the beginning, special gifts were given to different groups of people. The caregivers were endowed with compassion for the less fortunate. The engineers were given the ability to see what was not yet there. The carpenters were given patience to set straight lines and perfect angles. The technicians were provided with diligence so that they might conscientiously follow the blueprints and detailed directions of others. The experimental scientists were given the certain belief that the world could be manipulated according to their vision of it...And finally there remained one last group and one last gift. These were the explorers. To them was given the gift of curiosity that they might forever observe the world as it is and seek to understand the many wonders of the world and the special gifts given to others."

"But what of the evaluators? You have not mentioned their special gift."

Malcolm smiled. "The evaluators, dear children, were spread throughout all the other groups, each endowed with the special gift of their own group, and each using that gift in a special way."

"But does that not make for much arguing among evaluators about who has the most special gift of all?"

Malcolm smiled.

Extracted from Patton (1980), p39

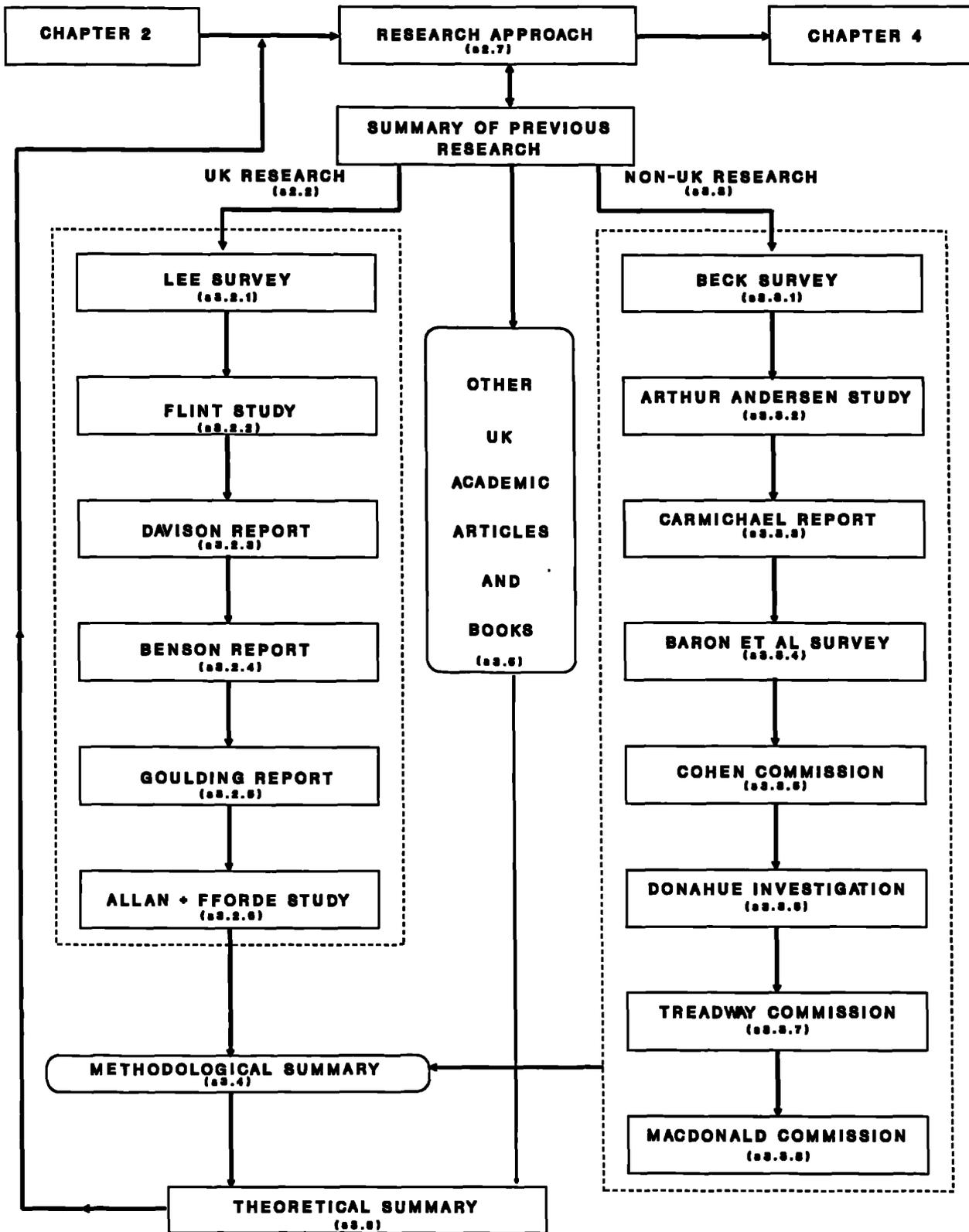
3.1 INTRODUCTION

The previous chapter concluded by saying that a literature survey was necessary to justify a historical approach to the study. This chapter has sought to document that 'exploration' and 'evaluation' (see Figure 3.1). It starts by carrying out a review of some of the past empirical research studies carried out in the UK pertaining to the auditor's responsibility relative to fraud detection during the past twenty years.

They are the Lee Survey (1970), Flint Study (1984), Davison Report (1985), Benson Report (1985), Goulding Report (1986) and Allan & Fforde Study (1986).

This is then followed by a brief review of similar research efforts (in the area of fraud detection and the auditor) carried on outside the UK.

Figure 3.1 : FRAMEWORK OF CHAPTER 3



A brief review was also carried out into some of the other academic articles and books written in the UK about the auditor and fraud detection. Finally an overall review (methodologically and theoretically) is presented on the whole 'exploration'.

The literature review was undertaken to serve a four fold purpose:

- a) To determine the extent of the empirical research conducted in the area of fraud detection, through the auditing process;
- b) To avoid duplication of methodology and/or findings;
- c) Following from (b), to provide the basis for an original contribution to existing knowledge in relation to methodology and/or findings, and
- d) To establish (in Chapter 4) an original conceptual methodological framework necessary for a deeper understanding of the auditor's role relative to fraud detection over time.

3.2 PAST UK RESEARCH STUDIES

3.2.1 LEE SURVEY (1970)

This was a questionnaire survey administered by Professor T A Lee of the University of Edinburgh. Respondents were asked to identify objectives which they perceived (then) to be a current company audit objective from a list of thirteen suggested company objectives. Amongst those listed were:

- a) To detect major fraud and error in the company
- b) To prevent major fraud and error in the company

Respondents were statistically selected to represent three groups, each of which was defined as having an interest in the audit function as seen in Figure 3.2.

The survey assumed implicitly that the respondents had a contextual understanding of the terms used such as fraud, adequacy of company operations, efficiency and adequacy of company management.

Figure 3·2 : RESULTS OF LEE'S (1970) SURVEY - IDENTIFICATION OF CURRENT OBJECTIVES

	SUGGESTED OBJECTIVE	
	TO DETECT MAJOR FRAUD AND ERROR IN THE COMPANY	TO PREVENT MAJOR FRAUD AND ERROR IN THE COMPANY
	%	%
Auditees		
Company Directors	82	53
Company Secretaries	81	50
Company Accountants	89	82
Auditors		
Partners in Audit Firms	82	83
Qualified Audit Staff	84	85
Nonqualified Audit Staff	87	82
Audit Beneficiaries		
Private Investors	81	77
Institutional Investors	100	77
Indirect Investors	81	54
Other Interested Parties	88	71

In view of the fact that respondents were asked to identify current objectives, as opposed to normative objectives, and in as much as the official professional view of Scotland is to regard the detection of fraud *"as a very minor aim of the present company audit"* [Lee (1970), p293] it is, perhaps, somewhat surprising that more than 80% of all those surveyed chose the detection objective. It is also surprising to note that the opinion of the auditors, regarding this objective, closely approximated that of the non-auditors. It is important to note however, that the objective as stated included the potential for differing interpretations. The use of the word 'major' introduced the idea of materiality. Some auditors may have exhibited a different opinion had that adjective been omitted from the objective. Moreover, the objective really listed two

responsibilities: the detection of major fraud and the detection of major errors. Had those responsibilities been listed as separate objectives (eg to detect major fraud and intentional errors; to detect unintentional errors), the results might have been different.

The prevention objective is also stated as a compound objective. Hence, its results too are subject to the criticisms of an undifferentiated response. It can be noted that the auditors' responses to this objective are very similar to their responses regarding the detection objective while the non-auditor groups had a tendency to indicate a lesser preference for prevention being identified as a current audit objective. From an analysis of the survey it was not possible to ascertain what the auditor perceived his responsibility to be for the prevention of fraud. It may be that he viewed the audit itself as a deterrent; or he may have contemplated taking a more active intervention role in company activities. The questionnaire was not designed to ascertain these effects.

Also due to the closed nature of the questionnaire, a listing of current audit objectives had to be given. The survey did not ask respondents to give any weighting to the importance of the objective relative to others. Although respondents may believe strongly that a given statement reflects an objective of an audit, it is possible that it may be of lesser importance than other specified objectives. Moreover many of these items cannot really be regarded as part of the present company audit objectives either because they are impossible to achieve or because the present auditor - a professional accountant - is not qualified or trained to cope with them, even in the 1990s. Examples of this type include ensuring all legal requirements have been complied with the company, guaranteeing the accuracy of the company's financial accounts, to give an opinion on the efficiency and adequacy of company management. Nevertheless, the suggested 'impossible' areas in the questionnaire were supported by individual participants; even more surprisingly also by auditors themselves. It would have been better if the key words such as ALL (legal requirements), GUARANTEE (accuracy of accounts), EFFICIENCY AND ADEQUACY (of company management) were highlighted expressly to draw the attention of respondents. The replies could have been different then, as most of the questionnaires would normally be completed in haste by the respondents.

What was also lacking in the questionnaire, but would be relevant is the auditor's responsibility for reporting fraud.

3.2.2 FLINT STUDY (1984)

This was only a pilot survey carried out for the APC by Flint et al (1984) on the perception of the responsibility of auditors in relation to the detection of fraud and irregularity. Its purposes were to provide direction to the APC on the scope of guidance which might be offered respectively to auditors and to users and also to pave the way for more detailed surveys in the future.

The pilot study was carried out in the form of questionnaires distributed to auditors and to users of financial statements. In addition to the main question stated earlier, opportunity was taken to ask questions relating to specific audit tests, currently in use, for the detection of fraud and irregularity, audit costs in relation to any desired increase in the auditor's responsibility over that currently perceived and individual's perception of the responsibility of company directors or their equivalent in relation to the prevention and discovery of fraud and irregularity. The views sought were however restricted geographically to the major cities like London, Edinburgh and Glasgow.

From the responses received it became apparent that there was no consensus of opinion on any question either as to what is perceived as current responsibility or as to what the responsibility ought to be. This lack of consensus exists within and between the groups to which the question was addressed.

Not only was the sample size small but the response to the questionnaire was poor, particularly from the auditors (32%) and only 26% from users. It was noted in the study that a number of respondents were critical of the complexity and the amount of time which it would take to complete the questions. Within the limitations of the significance of the results highlighted, it is a matter of concern, even of alarm, that there is a disparity of view especially among auditors as to the nature of auditors' responsibility. In addition there is little evidence of their recognition of the need for a preparedness to accept a more specific responsibility in response to the users' expectations or requirements.

The consequence is that it must be emphasised that the results are not conclusive but, particularly since they are in parts subjective, impressionistic interpretations are thus only indicative.

3.2.3 DAVISON REPORT (1985)

The working party chaired by Ian Davison was established to examine and comment mainly on:

- a) the nature of fraud;
- b) the general issues arising in relation to its prevention, detection and investigation;
- c) considering whether changes were required in the Chartered Accountant's responsibility in relation to fraud.

The report was laid out in a series of recommendations, taking the view that it is impossible to devise laws, regulations or controls that will eliminate fraud or that will guarantee its discovery, but arguing that it is possible to reduce fraud or deter it. It emphasised that management should be the first line of defence. Directors should bear the primary burden of detecting fraud and should set up appropriate internal controls. Auditors should be a second line of defence, and should be encouraged to report serious cases of suspected management fraud to the authorities.

The report and its list of recommendations is based on the experience of its ten member team consisting of auditors, businessmen, liquidators and tax advisers. Whilst the team may seek to portray the views of their respective professional spheres, it is doubtful whether their views are representative of the wider community of which they represent without any further research or validation. As all the recommendations were expressed in a normative way (...should...), it is difficult to locate whose values are predominantly reflected in a particular recommendation. It would seem naive to assume that all the team members' views were equally reflected in all the recommendations.

3.2.4 BENSON REPORT (1985)

Here, the (then) ICAEW Institute president Brian Jenkins had asked Lord Benson, ex-chairman of the Royal Commission on legal services to head a working party to prepare a swift report (within one month) on the auditor's responsibilities for reporting suspected fraud. Specifically, he had to consider the case for any amendment to the

Institute's present guidelines and to comment on the wider implications of any change in the auditor's duties, in the context of the imminent Financial Services Bill then.

The study, produced by a committee of ten people, followed a stiffening of the Institute's guidance to members on the subject. It did no more than to draw together the present position concerning the auditor's responsibility towards fraud. It made it quite clear that the auditor had no responsibility to prevent or to detect fraud and that responsibility must lie with the management of each company. However, it was felt essential that the auditors take seriously their responsibilities to follow through any indications of fraud so as to discover their source, and that they take equally seriously their responsibilities to report to the public on any matters which could affect the opinion of the readers of the financial statements.

It is also argued that whenever an auditor qualifies or intends to qualify his audit report on the grounds of suspected fraud, he should send a copy of the accounts and his audit report to the Department of Trade and Industry, and inform his client that he has done so.

As the approach of this report was similar to the Davison Report, the comments to be made here will be similar to the comments made on that report (see Section 3.2.3).

3.2.5 GOULDING REPORT (1986)

The Working Party on Fraud was constituted in November 1985 by the Council of the Chartered Association of Certified Accountants. The Working Party chaired by Sir Irvine Goulding acted upon the following terms of reference:

- a) to consider the issues relating to the auditor's responsibilities for detecting and reporting fraud, including the purpose, scope and nature of the auditor's report, and if appropriate recommend amendments to the present guidance given to members of the Association;
- b) to consider the wider implications for the business community and in particular the financial services sector and the public of a change in the auditor's present duties; and

- c) to take into account current expectations of the financial public regarding the above issues, and to make recommendations.

As a result, Goulding et al (1986) recommended the Association to commission an independent attitude survey to research the public's individual perception of the current duties of auditors in the areas of fraud and irregularity and to assess the reaction to a possible extension of the auditor's legal duties.

The Working Party concluded that the law, current auditing standards and guidelines and guidance given to auditors in the member's handbook of the Association should not be extended to provide a distinct duty on auditors to detect and/or report (to a third party/authority) fraud. It recommended that audit committees should be established and the term 'public duty' should be carefully defined.

Whilst the survey contained the views of the public (directors of public companies, principal shareholders/managing directors of private companies, executives), it deliberately excluded practising accountants. As the expectation gap is between the public and the accountants, it is felt that such an exclusion will not enable a proper understanding of this gap.

The questionnaire was mailed to specific individuals for each of the seven groups. There is no way to determine whether the returned questionnaires were in fact, answered by the particular individual selected or whether the questionnaire was completed by a surrogate for the selected individual.

Although efforts were made to remove ambiguities and any possible misunderstanding of the terms used in the questionnaire, there was no way to determine whether or not interpretations of the questionnaire statements were the same for all respondents. In addition to that, the nature of the questionnaire was to use rather brief declarative statements and to ask the sample participant to respond by choosing from various options ranging from 'yes' to 'don't know' to 'no' or 'not at all' to 'a fair amount' to 'a lot'.

Respondents to the short declarative statements of the questionnaire may have had to make certain assumptions due to the general nature of the statements and the lack of

background material provided for each fraudulent situation. Moreover, the sample sizes were small (totalling 100); hence the results could not be regarded as definitive.

Nevertheless its survey method was based on the use of three media - telephone, face to face and postal reply (predominant source) coupled with three interviews which helped to some extent to reduce the possibility of interviewer/method bias.

Further study will be needed to either collaborate or refute the concluding views of the Working Party. This could be accomplished by providing sample members with more concrete examples in given fraudulent situations through the usage of the case study method.

3.2.6 ALLAN & FFORDE STUDY (1986)

When the APC issued an exposure draft of an auditing guideline *Fraud and other irregularities* in May 1985, it also conducted a survey of attitudes towards the auditor's responsibilities for preventing and detecting fraud. It was designed to assess whether there was a demand for change and whether change was practicable and cost effective.

In all, 88 responses to the questionnaire were received from accountancy bodies and firms, Government and other authorities and accountants in practice and commerce. These responses have been analysed by Richard Allan and William Fforde of Peat Marwick, and showed that:

- a) there was little support for the suggestion that the auditor should accept a general responsibility to detect fraud,
- b) 40% believed that extending the responsibility to detect fraud would require limited liability to be given to auditors,
- c) there was strong support for auditors reporting significant frauds and irregularities to shareholders; only a minority favoured a responsibility to report to anybody other than shareholders; and
- d) respondents generally believed that management should have a statutory responsibility to maintain an adequate system of internal control, compliance

with which would be a matter to be considered by the auditor. For practical reasons, smaller companies would be exempt from this requirement.

The research was essentially a qualitative survey conducted with open-ended questions but only on a relatively small scale. Although the questionnaire was made available to the business community in general, it should be noted that the majority (85%) of the response was received from accountancy bodies and practitioners.

The findings could also not be seen as representing the views of the accountancy profession as a whole due to the low response rate; rather they were a sample of opinions which may assist the APC in formulating further guidance on this subject.

3.3 PAST NON-UK RESEARCH STUDIES

In this section, it is decided to carry out a less detailed review than those carried out in the UK over the past twenty years. The research studies highlighted in this section are the Beck Survey (1973), Arthur Andersen Study (1974), Baron et al Survey (1977), Carmichael Report (1975), Cohen Commission (1978), Donahue Investigation (1979), Treadway Commission (1987), MacDonald Commission (1988). The first research was conducted in Australia and the last one in Canada. The rest were carried out in the USA.

3.3.1 BECK SURVEY (1973)

The research method involved a survey sent out to 1,561 individuals selected at random from each of the share registers of two major Australian companies, one in mining and one in retailing. These companies have just under 80,000 and 50,000 shareholders respectively and the holdings were very widespread. Companies, societies and overseas shareholders were not included in the sample size. The usable responses received totalled 711 (45.5%).

The questionnaire despatched consisted of 32 assertions about accountants with which the respondents were asked to strongly agree, agree, disagree, disagree strongly or to indicate that they were uncertain. Fifteen of these assertions were concerned with auditors. The Beck survey on perceptions of the auditor's role did not specifically ask a

question relative to the responsibility for detecting fraud. Rather, it dealt with the related issue of assurances that fraud had not been committed.

Of the 93% of shareholders agreeing that the auditor is expected to give assurances that no fraud has been perpetrated by company officials, approximately 80% held strong opinions. Beck (1973) noted that the high percentages of people who expect to find the accounting statements reliable, that there have been no frauds, and that management has discharged all statutory duties were predictable.

The responses of the Beck survey was interesting from the standpoint that the respondents' attention was directed to frauds perpetrated by company officials rather than the open ended objective of no frauds being committed. The Beck survey appears to focus on management fraud rather than fraud or embezzlement by lower-level employees. Fraud at the company management level may go undetected by reliance upon the internal control system. A better interpretation of the nature of the responses would have been possible if a differentiation had been made between management fraud and lower-level employee fraud or embezzlement. The absence of this differentiation does not insure that the respondents were making this differentiation in their opinions.

3.3.2 ARTHUR ANDERSEN STUDY (1974)

Arthur Andersen via Opinion Research Corporation (USA) conducted a cross-sectional survey via face to face interviews on corporate executives and other 'key public' (eg accountants, institutional investors, etc) and also by means of telephone interviews on individual shareholders. One of the core questions dealt with the importance associated with the auditor's responsibility for the detection of fraud.

Significant to a critique of this study, perhaps is, the fact that respondents were asked whether or not they felt detection of fraud was the most important function of an audit. Some respondents may have regarded the detection of fraud as being an important function of an audit, but not the most important function. The questionnaire did not cater for this regard. In addition, the question did not allow for a differentiation between respondents' replies as to the auditor's current responsibility and his normative responsibility, ie what it should be.

Moreover, while generalisations may be induced at a 95% confidence level from the shareholder sample and the corporate executive portion of the key sample to the entire universe for each, generalisations may not be made as to the other key public groups. This is attributable both to the smallness of the sample sizes and to the non-random manner in which they were selected.

3.3.3 CARMICHAEL REPORT (1975)

This report prepared solely by Carmichael represents a background paper which was subsequently used by the Commission on Auditors' Responsibilities in 1978. It probes the question of whether the independent auditor should be held responsible if his ordinary examination of financial statements fails to detect a material fraud?

The report follows only very briefly (based on the views of Dicksee 1905, Montgomery 1923, Staub 1942) the evolution of fraud in accounting literature as a major objective of the audit in the 1900s, when it was considered the first of such objectives, in the statement on Auditing Standards (SAS) No1 §110.05 which says that the responsibility of the independent auditor for failure to detect fraud arises only when such failure clearly results from non-compliance with generally accepted auditing standards. This is an inadequate approach to defining the auditor's responsibility because it does not specify what frauds an examination in accordance with generally accepted auditing standards is designed to detect. As it is based on secondary sources, it thus is lacking in depth (around 8 pages) both in content and rigour on the historical context. The report then considers possible approaches to specifying the auditor's responsibility for detection of fraud and concludes that none of them appears adequate.

It concluded that the profession must take a new position on the auditor's responsibilities in this area, making several value judgements that take into account, among other considerations, the cost of the additional audit work necessary, the likelihood of success in the search for fraud, and the probability of occurrence of various material errors and irregularities.

3.3.4 BARON ET AL SURVEY (1977)

This was a closed questionnaire survey on the expectation gap between large firm audit partners and other major segments of the financial community as to their beliefs concerning the auditor's responsibility for a) detecting and b) disclosing corporate irregularities and illegal acts.

Definitions were provided as to the terms 'deliberate material falsifications' and 'other material misstatements'.

Deliberate material falsifications were defined as:

"...distortions of the financial statements by corporate management in order to deceive the investing public..."

Baron et al (1977), p57

Other material misstatements were defined as:

"...distortions of the financial statements resulting from various forms of improper or illegal behaviour on the part of corporate officers or employees..."

Baron et al (1977), p57

Even though the main distinguishing attribute between the two definitions lies in the hierarchy of staff rather than the nature of the fraud, it is possible that the respondents might place a higher responsibility bias on the auditor due to the term 'falsification' rather than 'misstatements'. If the words were switched around, so that it became 'deliberate material misstatements' and 'other material falsifications', one does wonder whether the same responses would have been obtained.

A cautionary note should also be sounded regarding this survey, ie less than 25% of the questionnaires were returned in usable form. The number of responses range from 105 to the lowest of 35. Therefore, it is possible that the views of the respondents were not representative of their respective universes taken as a whole.

3.3.5 COHEN COMMISSION (1978)

The work of the Commission on Auditors' Responsibilities represents an indepth study of the auditor's role, including his duties for the detection of corporate fraud and illegal

acts, in the context of the expectation gap. The Commission chaired by M Cohen had a working party of 21 staff which comprised academics and professional accountants. They conducted a series of research projects and surveys of legal cases, met and consulted with a variety of interested parties and considered a range of issues concerning the independent audit function. It also looked at some of the previous research projects.

On the whole, the Commission calls for an expansion of auditor responsibilities for the detection of irregularities and illegal acts that goes beyond SAS No16 (*The Auditor's Responsibility for the Detection of Errors and Irregularities*) and SAS No17 (*Illegal Acts by Clients*). Its recommendations are more reflective of the preferences expressed by financial analysts and bankers in the survey data. For example, the Commission's recommendations are stronger and more specific to SAS No16 with respect to irregularities. The Commission recommends that the auditor should actively search for fraud and the audit should be designed to provide reasonable assurance that the financial statements are not affected by material fraud.

Whilst it was a fairly thorough study of the extant circumstances then, it placed little emphasis on trying to understand historically how the detection of fraud as an objective of the audit has been steadily eroded or how the past has shaped its present role.

3.3.6 DONAHUE INVESTIGATION (1979)

The purpose of this study was to gather empirical evidence that either verified or refuted the existence of an expectation gap between various financial statement user groups and the certified public accountant as to the responsibility of the independent auditor for the detection, prevention and disclosure of fraud.

The methodology employed in this investigation included both a very brief review of the literature and a closed questionnaire survey. The data was subjected to statistical tests to determine whether or not significant differences exist between the opinions of certified public accountants and the other four sample groups.

The results of this research study tend to support the earlier conclusions of the Baron et al Survey; that an expectation gap appears to still exist between certified public accountants and other financial statement users as to what the auditor's responsibility

should be for the detection, prevention and disclosure of fraud. The expectation gap seems to continue to exist despite the recent attempts on the part of the AICPA's Auditing Standards Board and the Commission on Auditors' Responsibilities to narrow it.

It should be pointed out that this research effort was only based on a normative concept; that is, participants were asked what the responsibility of the independent auditor should be rather than what it is, according to the profession's latest official pronouncements.

3.3.7 TREADWAY COMMISSION (1987)

The six-member Commission headed by J Treadway Jr, was a private sector initiative, jointly sponsored and funded by the American Institute of Certified Public Accountants (AICPA), the American Accounting Association (AAA), the Financial Executives Institute (FEI), the Institute of Internal Auditors (IIA), and the National Association of Accountants (NAA).

The Commission studied the financial reporting system (of public companies only) in the United States to identify causal factors that can lead to fraudulent financial reporting and steps to reduce its incidence. To this end, a research programme was set up involving more than 20 research projects and briefing papers, reviewed previous and current related research studies and interviewed numerous experts. It concluded with numerous recommendations for the public company, the independent public accountant, the SEC and others, and for education.

But though the principles behind the Commission's findings look sound to anyone involved in the world of business and finance, doubts must remain as to whether the recommendations will be effective when implemented. For one of the major themes of the Commission is an aversion to compulsory measures either through legislation or professional regulation. It emphasises improving the 'tone' of US management but not to introduce legislation to deal with those who may refuse to comply.

For example, the Commission's recommendations for public accountants also rely on a very large measure of voluntary cooperation. According to the Commission, audits can

be made more effective in discovering fraud if peer and second partner reviews are introduced. But implementation looks likely to be left to firms and not by regulation.

But while the ambition may be admirable, its realisation may produce some practical difficulties. For while 'good' firms and 'good' companies may comply with the rules, without legislation there may be little to stop the fraudster carrying on his trade.

3.3.8 MACDONALD COMMISSION (1988)

The research here involves a two year study by a commission set up by the board of governors of the Canadian Institute of Chartered Accountants (CICA) with the task of studying the public's expectations of audits. The nine man commission, of whom four were accountants and which was chaired by W MacDonald, concluded its study by setting out 50 recommendations to the CICA board of governors.

To ascertain what the public expectations were, the Commission, interalia commissioned a major public opinion survey via telephone interviews. Other sources of information were public hearings, written submissions and meetings, reviewing non-Canadian surveys and consultation with knowledgeable parties, including representatives of the accounting profession and financial regulators in the USA and England.

Nine recommendations related to the topics of fraud, illegal acts and changes of auditor. In particular, auditors should extend their work to give specific consideration to the possibility that management fraud may have occurred and the CICA auditing standards committee was urged to prepare guidance on audit procedures related to the discovery of such fraud.

The Commission further recommended that auditors see that audit committees are fully informed about frauds which affect, or could have affected, materially the financial statement and about any significant weaknesses in internal control, particularly to prevent fraud.

However the report is limited in that it only concentrated on the expectations of the auditors of public companies only, ignoring the private companies.

3.4 METHODOLOGICAL SUMMARY OF PAST EMPIRICAL RESEARCH

It was found that the methodologies employed outside the UK were very similar to those conducted in the UK. In consequence, they resemble the nature and limitations of past UK research too.

The methods used to conduct research are important. Auditors using statistical sampling will know that the results of a sample can only be generalised to the population if that sample is representative, and that the results cannot be generalised beyond the population from which the sample has been drawn. Similarly the validity of the conclusions of studies of the audit function in relation to fraud detection depends in part on the research method used. Figure 3.3 summarises in a tabular format the various research methods applied in sections 3.2 and 3.3.

The following descriptions give a basic outline of the principle strategies which have been used in auditing research on the topic of fraud detection.

a) Questionnaire Survey

Under this method a sample of subjects complete a questionnaire designed to elicit their opinions or practices on some aspect of auditing. Such surveys are normally conducted by mail (with closed or open-ended questions), although they are some sometimes followed up by interviews (face to face or telephone). Questionnaires may be sent to different groups of people, for example auditors and shareholders, in order to allow comparison of results. Questionnaire surveys are relatively easy to conduct but suffer from the problems of low response rate, subjects interpreting a question in different ways and of subjects giving the answers that they think are expected, rather than stating their actual opinions or practices.

b) Other Surveys

Using a questionnaire involves creating a set data which is subsequently analysed. Some research has simply attempted to survey, resummarise or reutilise data which is already available; for example surveys of past empirical

Figure 3.3 : SUMMARY OF METHODS USED IN PAST EMPIRICAL RESEARCH STUDIES

Research Studies Research Methods	United Kingdom						United States						Australia	Canada
	Lee Survey (1970)	Flint Study (1964)	Devion Report (1966)	Benson Report (1966)	Coaling Report (1966)	Alan & Fiore Study (1966)	Arthur Anderson Study (1974)	Cannichal Report (1976)	Bass et al Survey (1977)	Cohen Commission (1978)	Danzus Investigation (1978)	Treasury Commission (1987)	Beck Survey (1972)	MacDonald Commission (1968)
A Questionnaire Survey mail → Closed → Open Ended	✓	✓			✓		✓		✓	✓			✓	
Focus to Focus Interview → Telephone					✓									✓
B Other Surveys														✓
C Working Party Commission			✓	✓										✓
D Historical Analysis								✓						

studies on the auditor and fraud or surveys of legal cases relevant to a particular aspect of auditing.

c) Working Party or Commission

This would normally involve a team of researchers (with a chairperson) who are given a set of stated research objectives whereby they are required to come up with findings, conclusions and recommendations by a certain date. They normally carry out a series of intensive meetings where they consider a wide range of issues and exchange their views based on their specialist experience in their own field. The outcome of all the debates and discussions are then synthesized into a report; for example, a report forming a background to the Institute's recommendations to the Government on the issue of fraud reporting.

Some evaluation of these three alternatives have been made in the earlier section of this chapter. Each has its strengths and weaknesses. For example, a questionnaire survey allows opinions to be collected from a very wide sample of individuals, but may not provide the detailed information which can be gathered from a case study. There is no single 'correct' method of conducting research, and as illustrated in Figure 3.3, some studies have utilised a number of different strategies in order to avoid the weaknesses of using only one method, ie triangulation.

Finally, it should be pointed out that the emphasis of the researchers above appears to be highly in favour of quantitative methods, at the expense of qualitative methods. Thus, the value of and the findings from a qualitative perspective have been much undermined.

The strength of a qualitative research approach is that it is inductive in that the researcher attempts to make sense of the phenomena without imposing pre-existing expectations on the research setting. Qualitative methods begin with specific observations and build toward general patterns. Categories or dimensions of analysis emerge from open-ended observations as the researcher comes to understand organising patterns that exist in the empirical phenomena under study. It is a discovery-oriented approach which minimises researcher manipulation of the study setting and places no prior constraints on what the outcomes of the research will be.

This contrasts with the predominant hypothetico-deductive approach of the quantitative methods of contemporary researchers which require the specification of narrowly defined operationalised variables and the statement of specific research hypotheses before the data collection. Unlike qualitative methods, it does not allow other, and possibly important dimensions to emerge from the analysis of the phenomena under study by presupposing in advance what those dimensions will be.

3.5 REVIEW OF OTHER UK ACADEMIC ARTICLES AND BOOKS

A brief review was carried out here with the aid of a computer search in order to get a feel of the prevailing thoughts in some of the articles and text books in the UK.

Flint (1971) suggested that over time there have been shifts in the responsibility of auditors for the detection of fraud. His view is that whereas in the nineteenth century and early twentieth century, fraud detection was a major objective of an audit, its prominent role was gradually relegated to an attestation duty to the overall truth and fairness of a company's financial statements. The evidence supporting this viewpoint was not based so much on statute or case law but on other sources; eg the views of professional bodies or statements made in standard auditing texts. On the latter source, prior to the more formal codification of auditing standards, these were one of the best indicators of generally accepted auditing practices, and to a certain extent carry semi-authoritative status.

The majority of the academic articles written in the area of fraud detection tend to focus on the auditor's performance. Johnson et al (1989) concentrated on understanding the audit judgement of practicing auditors in the task of fraud detection. It reviewed the lens model work of Ashton (1974) and continuing through the heuristic work of Joyce and Biddle (1981) and proposed that a theory of the task of auditing be developed as a means of providing hypotheses regarding the operative knowledge underlying successful task performance.

Woolf (1989) commented that some audit engagement letters still contain a blanket disclaimer of responsibility for fraud detection, but such disclaimers are practically useless against negligence allegations. It concluded that auditors cannot reasonably be expected to disclaim all responsibility beyond confirming consistency of accounting policies used and checking the arithmetic.

As far as auditing textbooks are concerned, the focus on the auditor's duties towards fraud detection is based primarily on the latest auditing guidelines from the profession and secondly only on a very few examples from case law. There is very little mention of statute law as if it is of no relevance to the auditor presently and also in the past. The text books also tend to focus on the auditor's general responsibilities, touching very briefly on fraud detection.

Sherer and Kent (1983) used the ideas of Brown (1962) and Flint (1971), the *Kingston Cotton Mill (1896)* case and the Auditing Standards and Guidelines to conclude that an auditor has no duty to detect fraud and error.

Though Woolf (1986b) considered the topic of importance, it only considered very briefly the (then) Auditing Practices Committee's viewpoint and contrasted the public's attitude towards fraud detection. It then went on to produce a 'fraudulent' checklist to assist the auditor in recognising some of the most obvious features of fraud existing in companies.

Lee (1986) had a chapter on the nature and purpose of company auditing, with particular reference to its current objectives. A detailed statement of these objectives (which included fraud and error detection) was given following a brief outline of their historical development. How he arrived at those objectives and the refinement into primary and secondary objectives were not made apparent to the reader. It concluded that the responsibility for detecting and preventing fraud in the company is now generally accepted as that of company management.

Gray and Manson (1989) wrote about the latest professional pronouncement and only used three case law examples to arrive at their conclusion of the auditor's present responsibility of fraud detection.

Tweedie (1991) wrote a chapter called *Fraud-Managements' and Auditors' Responsibility for its Prevention and Detection*. It looked briefly at the position of the accounting profession in 1985, using the Davison Report and the Benson Report of that year. It then moved on to focus on the current position looking at the latest statutory requirements and professional guidance.

3.6 THEORETICAL SUMMARY OF LITERATURE REVIEWED

The literature reviewed here has been largely concerned with the auditor's extant responsibility and the public's perceptions. Its historical dimension appears to have been much ignored, as if it is totally irrelevant.

There is thus a gap in the literature regarding how the auditor in the UK cognitively perceives his role and how that role has evolved with respect to fraud detection. The auditor's role can be derived from (in decreasing order of liability) statute law, case law, official pronouncements of the profession, in contract with the client and in tort to third parties. It is unknown to what extent individual auditors are aware of their role with regard to the levels of liability or whether their own views correspond to these levels currently and with respect to time.

To the extent that the literature and the official pronouncements of the profession represent the perceptions of individual auditors, the perception is one of limited responsibility. Some auditors disclaim all responsibility for the detection of fraud and contend that the ordinary examination is in no way intended to achieve that purpose. This perception and the one of limited responsibility would appear to be variance with the expectations of user groups as illustrated by the empirical research.

What is not clear from the aforementioned surveys and other literature is the range of the legal interpretations that could possibly emerge from statute law. Its legal meaning is assumed to be unproblematic and to be uniformly understood. But is that so?

In information processing terms, a theory of auditing is a theory of what must be computed by any processor that attempts to perform an audit. Different processing modes by different types of processors will lead to an implementation of a given computation in accordance with those interpretations and constraints of understanding.

At the level of professional auditor, this operative statutory knowledge is the expertise required (amongst other things) to perform the audit task. If such knowledge is required to perform and discharge their statutory duties, then it is crucial that auditors understand the underlying reasoning and meaning of characteristics of that statutory task and the dynamics of its evolving role with its environment.

The difficulty with the approach taken by audit researchers thus far is that the formalism of the auditor's responsibility has been confused with the content of that responsibility. Rather than looking only for 'rules' in the problem-solving data of a task, analysis must also identify and re-search into the contents of these documents that guide what the auditor does.

This research attempts to come to grips with two of the neglected issues raised above, namely the problematic nature of legal interpretations, and the dynamics of the auditor's evolving statutory role in the context of fraud detection.

In one sense, this work also falls victim to criticisms made of other work in auditing - namely it has not looked into all the influencing factors affecting the auditor's role towards fraud detection. Due to the practicalities of time and cost constraints and also the wide historical time span involved, it has chosen to confine the focus to one influencing factor, namely statute law.

3.7 ENVOI

A couple of general points or qualifications must be remembered when drawing conclusions from any area of research:

- a) The results of a research study cannot be divorced from the way in which they have been obtained. An appreciation of the research method and its limitations is important.
- b) Care must be taken in transferring the findings of research into contexts other than that in which the research was undertaken.

This latter point has a particular significance in the field of auditing. There is some disparity between the amount (both in number and depth) of audit research undertaken in the UK and the volume of research elsewhere, in particular the US. Given the lack of depth of UK research, a review was also made to a number of studies conducted outside the UK.

The differences in the auditing environment in different countries must also be taken into account when comparing the findings and drawing conclusions about the UK.

It should also be pointed out that there is virtually no indepth historical analysis conducted at all in the literature reviewed so far on the auditor and fraud detection, especially in relation to statute law. This has been the inevitable outcome due to the researchers' preoccupation with extant circumstances and quantitative methods. Whilst there is a place for research into the extant circumstances, to ignore or neglect a proper understanding of its past (in relation to its present) will inevitably leave a vacuum of this complex evolving process of the auditor's role towards fraud detection. A switch of emphasis to qualitative methods is also much called for to address this qualitative-quantitative imbalance.

Gwilliam (1987b) commented that there is a lack of research that seeks to discover more about the role of auditing and the relationship between the auditor and the legal environment within which he works. Gwilliam and Macve (1988) also commented that research should include topics of importance in the current auditing environment such as the auditor and fraud. This piece of research is undertaken in response to fill some of this research gap, both methodologically and theoretically by adopting a qualitative approach and a historical analysis respectively.

"Support for additional research and the increased scope of knowledge derived therefrom would enable the collective accountancy bodies to take a leading role in identifying areas of change in the profession (or in highlighting those areas where change is inappropriate) and thereby to make a significant contribution to shaping the audit profession as it enters the 1990s"

Gwilliam (1987b), p49

Having set out a general framework of the methods used in past research, and a number of points concerning the theoretical evaluation of literature reviewed, we shall now proceed to the next chapter to consider the specific methodological design employed for this research.

CHAPTER 4

RESEARCH METHODOLOGY

4.0 PRELUDE

*There is no single best way to do research. A major strength of any field is the diversity of approaches it tolerates and the atmosphere it provides for the exchange of ideas on the results and merits of each alternative. What is proposed here is but one of a number of directions audit research might proceed from its current position. The important thing is to recognize that ultimately it is the thoughts and actions...that need to be explained. For, as Ulric Neisser in his book *Cognition and Reality* (1976) notes:*

...The prediction and control of behavior is not primarily a psychological matter. What would we have to know to predict how a chess master would move his pieces or his eyes? His moves are based upon information he has picked up from the board so they can only be predicted by someone who has access to the same information. In other words, the aspiring predictor would have to understand the position at least as well as the master does. He would have to be a chess master himself. If I play chess against a master he will always win precisely because he can predict and control my behavior while I cannot do the reverse. To change this situation I must improve my knowledge of chess, not my knowledge of psychology...(pp182-183)

Johnson et al (1989), p98

4.1 INTRODUCTION

In the previous chapter a critical analysis was carried out on how the auditor's role towards fraud detection has been presented, studied and analysed in some of the more recent existing research and theoretical literature. It was shown that the bulk of empirical research tends to focus on quantitative methods. By exposing these trends and approaches in the existing literature, the researcher is then able to locate his study within and against this body of work.

The study here attempts to redress the imbalance by adapting a qualitative approach. Even though there appears to be considerable social science literature on qualitative research methods, it does not contain any extended treatment of the 'interpretive' existential point of view (Douglas and Johnson 1977, Kotarba and Fontana 1984). Nor

is there any serious account that applies this perspective to the evolving role of the auditor towards fraud detection. The present study attempts to fill some of this void by providing some interpretive explanations from the viewpoint of the researcher as an auditor.

This chapter seeks to describe the research method used for the cognitive study as seen in Figure 4.1. It seeks to obtain an insight into insight. Lonergan (1983) viewed insight as not an act of attention or advertence or memory, but the supervening act of understanding. It follows that insight into insight is in some sense a knowledge of knowledge. Indeed, it is a knowledge of knowledge that seems extremely relevant to a whole series of basic problems in philosophy.

The background to the method used is first explored and then its basic focus, features and implications explained. The rest of this chapter is then devoted to the approach formulated which is given the name of Epiphanic Interpretive Symbolic Interactionism or EISI for short. The components of this phrase are then defined and the concept of the epiphany discussed.

The EISI process consists of 6 stages, starting from framing to contextualisation, capture, bracketing, construction and consolidation. A diagrammatic overview is then finally presented to see how the various features relate to each other. EISI, as a cognitive mode of knowledge, is developed here to sensitise one's level of historical consciousness.

4.2 BACKGROUND

Back in 1887, Nietzsche stated that only things without a history are definable. Stinchcombe (1978) noted that the philosophical tradition summarised in Nietzsche's aphorism holds in that any entity produced by a unique course of events through time cannot be adequately described by general concepts. History then is informative to the degree that things are not instances of general categories, but are instead the product of a complex series of events that produce unique configurations in each of those things. Brown (1962) stated that a review of the history of auditing provides a basis for analysing and interpreting the changes which have taken place in audit objectives.

In *The Sociological Imagination*, Mills (1959) challenged scholars in the human disciplines to develop a point of view and a methodical attitude that would allow them to examine how the private troubles of individuals, which occur within the immediate world of experience, are connected to public issues and also public's responses to these troubles. Mills' sociological imagination was biographical, interactional and historical.

Since then, Denzin (1989) has taken up Mills' challenge and expanded it into what is called 'interpretive interactionism'. It refers to an attempt to capture and make the world of problematic lived experience of a subject or class of people directly available to the reader. The interactionist interprets these worlds. Weber (1947) saw the essential features of social science to be 'interpretive'; that is, to understand the subjective meaning of social action.

The research methods of this approach include document analysis; semiotics; life-history; life story; personal experience and self-story construction; participant observation and thick description.

The term 'interpretive interactionism' signifies an attempt to join traditional symbolic interactionist thought (Blummer, 1969), with participant observation and ethnography (Becker 1970, Loftland and Loftland 1984, Agar 1986, Fielding and Fielding 1986, Adler and Adler 1987), semiotics and fieldwork (Manning, 1987), post-modern ethnographic research (Turner and Bruner 1986, Clifford and Marcus 1986), naturalistic studies (Schatzman and Strauss 1973, Patton 1980, Lincoln and Guba 1985), the hermeneutical works of Palmer (1969), Gadamer (1975), Dilthey (1976) and Heidegger (1982), the case study method (Yin 1985, Stake 1986), phenomenology (Husserl 1929, Thevenaz 1962, Schutz 1967) and the cultural studies approach in Hall (1980).

The interpretive paradigm has its roots from the German idealist tradition of social thought, with its foundations laid in the work of Kant. Its origins reflected a social philosophy which emphasises the essentially spiritual nature of the social world. The idealist tradition was paramount in Germanic thought from the mid-eighteenth century onwards and was closely linked to the romantic movement in literature and the arts. Outside this realm, however, it was of limited interest until the late 1890s and the early years of this century when it was revived under the influence of the so-called neo-idealist movement. Philosophers such as Dilthey, Weber, Husserl and Schutz have

made a major contribution towards establishing it as a framework for social analysis, though with varying degrees of commitment to its underlying problematic.

4.2.1 BASIC FOCUS

The focus of interpretive research is on those events that radically alter and shape the meanings that human beings give to themselves and their experiences (Denzin, 1989). It attempts to make the world of lived experience directly accessible to the reader. It endeavours to capture the voices, thoughts and actions of those studied.

Interpretation is thus the process of setting forth the meaning of an event or experience. Meaning is seen in terms of the intentions and actions, actual or implied. According to Blummer (1969), meaning is triadic: it involves interaction between (1) a person, (2) an object, event or process and (3) the action taken towards that object, event or process. Meaning is thus interactional and interpretive. Interpretation clarifies meaning.

Meaning, according to Schutz (1967) is dependent upon reflexivity - the process of turning back on oneself and looking at what has been going on. Meaning is attached to actions retrospectively; only the already experienced is meaningful, hence the historical dimension of this research.

Interpretation brings out the meaning embedded in a text or slice of interaction to aid us in our understanding. It is the goal in the subsequent chapters. Understanding is the process of comprehending and grasping what has been interpreted in a situation or text (Ricoeur, 1979).

Understanding thus consists of circular and spiral relationships between whole and parts, between what is known and what is unknown, between the phenomenon itself and its wider context, between the knower and that which is known. This is a dialectical process which is in theory, an infinite process, although one may rest for some time at some acceptable point of intersubjective validity (Reason and Rowan, 1987).

Interpretivism is not for everyone. It is based on a research philosophy that is counter to and challenges much of traditional scientific research tradition in the social sciences.

Burrell and Morgan (1985) called such traditional dominant framework, the 'functionalist paradigm' which approaches the general sociological concerns from a standpoint which tends to be realist, positivist, determinist and nomothetic. The focus of this research is a move away from the objectivist - functionalist paradigm to the subjectivist - interpretive paradigm.

4.2.2 BASIC FEATURES

The interpretive paradigm is informed by a concern to understand the world as it is, to understand the fundamental nature of the social world at the level of subjective experience or thought. It seeks explanation within the realm of individual consciousness and subjectivity within the frame of reference of the participant. It will involve textual analysis of meaning and significance which was regarded by Dilthey (1976) as more appropriate than a scientific search for knowledge of general laws in the study of social-cultural phenomena. In its approach to social science, it tends to be nominalist, anti-positivist, voluntarist and ideographic (Burrell and Morgan, 1985). These are the basic features that prevail in the research methodology designed. It sees the social world as an emergent social process which is created by the 'actors' concerned.

These features needed to be explicitly stated since David Sudnow (1978) argues that the researcher's perspective is definitionally critical for establishing the 'what' and Denzin (1989) adds the 'how' of problematic social experience. This is first illustrated by Figure 4.2 and the terms on the left hand side (residing within the interpretive paradigm) explained below.

Figure 4.2 seeks to summarise the ontological, epistemological, human and methodological standpoints which characterise the subjective - objective dimension in research.

- 1) **Nominalism** A branch of ontology (the essence of the phenomena under investigation) whereby the 'reality' to be investigated is the product of individual consciousness and hence of a 'subjective' nature.

- 2) **Anti-positivism** A branch of epistemology (the grounds of knowledge) whereby knowledge is of a softer, more subjective kind, based on experience and insight of a unique and essentially personalised nature. It rejects the notion that one could generalise objective laws, establish definitively cause and effect relationships and henceforth predict mechanically.
- 3) **Voluntarism** A branch of human nature (the relationship between human beings and their environment) perceiving man as having a creative role and free will in creating and determining that environment in which he is located. The relationship in the very early stages, in certain context may be an intermediate transitional standpoint which allows for the influence of both situational and voluntary factors in accounting for the activities of human beings.
- 4) **Ideographism** A branch of methodology (the approach of investigation and obtaining knowledge) which seeks to understand the social world by getting to one's subject and exploring its detailed particular background and history and henceforth offer an interpretation.

4.2.3 BASIC IMPLICATIONS

Four heuristic implications prevail in this mode of research.

Firstly, in the world of human experience, there is only interpretation (Denzin, 1989). Everyday life revolves around persons interpreting and making judgements about their own and others' messages, behaviours and experiences. Many times these interpretations and judgements are based on faulty or incorrect understandings. Persons, for instance, mistake their own understanding of the message from that originally intended or their own experiences for the experiences of others. As a consequence, there is a gap or failure in understanding and misinterpretation which can be formulated into social policies. Hence, the analysis rests on the importance of understanding and interpretation of texts and events as key features of social life.

Secondly, in the world of societal perspectives, interpretation in a context is seen as a key feature in giving contained meanings to history. Unless the context is set, the effect on subsequent interpretations can remain clouded and possibly misunderstood.

Thirdly, it is a worthy goal to attempt to make these interpretations available to others. For then understanding can be generated. To make the invisible more visible to others is after all, a major goal of the interpreter (Merleau-Ponty, 1968). With these 'better understandings', come better social policies for addressing the major issues of our day.

Fourthly, all interpretations are in one sense unfinished and inconclusive (Denzin, 1984). This is due to a wide variety of possible factors, one of which is the unavoidable intellectual bias. The other is that due to the labyrinths and the multiplexities of ascertaining 'truth', one has to reject totalisation at the ontological or analytical level. The field of analysis must remain open and unbounded. The researcher can only propose the analysis of specific features of the social field, perhaps drawing some subjective connections between those features on other levels but no more than that. The totality remains a horizon of thought, never its object.

The implication, also shared by Danto (1973) is that the whole truth about any period in the past can never be told, that history is essentially incompletable. He has two reasons for this. One is that history is concerned only with significant events, which are at best, a fragment of the past. Moreover, events are continually being re-described and their significance re-evaluated in the light of later information. An identical event will have a different significance in accordance with the context in which it is located or in other words, in accordance with what different sets of later events it may be connected to. The other reason is that there can be no limit to the forward reference of statements about the past. Consequently, there will endlessly be the possibility of new truths about any period in the past, as they are indefinitely open to new comparisons and connections, new interpretations in the light of subsequent events and the changing interests and focus of researchers.

All researchers take sides or are partisans for one point of view or another (Becker 1967, Silverman 1985). An anatomy of power and feeling in the interpretive studies reveal that value free, detached, unemotional purely cognitive interpretation is impossible (Denzin, 1989). This is the case because every researcher brings preconceptions and interpretations to the problems being studied (Heidegger 1962,

Gadamer 1975). Gadamer argues that the circle of understanding as envisaged, for example, by Dilthey (1976) is not a methodical circle, but describes an ontological structural element in understanding, ie it is subjective.

Taking Heidegger's description and existential account of the hermeneutic circle as a point of departure, he argues that we cannot relate, for example, to a historic tradition as if it existed as an object apart from us, since there is an interplay between the movement of tradition and the interpreter. In order to understand social or cultural phenomena, the interpreter needs to enter into a dialogue with the text and subject of study.

As Giddens (1976) puts it,

"Understanding a text from a historical period remote from our own, for example, or from a culture very different from our own is, according to Gadamer, essentially a creative process in which the observer, through penetrating an alien mode of existence, enriches his own self-knowledge through acquiring knowledge of others. 'Verstehen' (understanding) consists, not in placing oneself 'inside' the subjective experience of a text's author (only), but in understanding literary art through grasping, to use Wittgenstein's term, the 'form of life' which gives it meaning"

(p56)

The term hermeneutical circle or situation used by Heidegger (1962) refers to this basic fact of research. All researchers are caught in this circle of interpretation. They can never be free of the hermeneutical situation.

Because of the researcher's unavoidable bias, cognitive limitations and possible conflictual, contradictory, inconclusive insights revealed in impressionistic accounts or discourses, no single story or interpretation will fully capture the problematic events that have been studied. So it is with this interpretation.

Lonergan (1983) saw knowledge as incomplete and subject to further additions; inadequate and subject to repeated future revisions. The researcher also shares Foucault's Nietzschean scepticism about 'truth': that there is no epistemological ground upon which one can stand to ontologise reason; to grasp the totality and claim definitely that it all leads to this or that. Foucault rejects totalisation at the ontological or analytical level.

In Foucault's examination of the conditions governing the production of statements he mentions a related term: archive. The archive is not, as its name might suggest, an inert depository of past statements preserved for future use. It is the very system that makes the emergence of statements possible. The archive of a period, let alone a society, cannot be described exhaustively. Foucault's analysis of discourse places statements in the dispersion of accumulation; it sees survival of archives as constantly subjected to reactivation, loss, and even destruction.

Such a philosophy of constructive alternativism (Bannister, 1987) contends that no interpretation of reality is absolute and irrevocable. This means that one does not have to spend time arguing against or disproving traditional notions but to proceed directly to offer an alternative construction of the confronting elements. One does not even have to force oneself to accept old interpretations. Such is the intellectual emancipation which this research so strongly advocates.

Nevertheless, in view of what has been said, Poster (1985) shared the view that methodological purity (or impurity) should not suppress intellectual curiosity. What this means is that whilst there is no single best way to do research, we should not be discouraged from experimenting with new methodologies.

4.3 THE APPROACH

4.3.1 THE PHRASE

The name given to the mode of cognition adopted is hereby addressed as Epiphanic Interpretive Symbolic Interactionism (EISI). The phrase signifies an attempt to join the symbolic interactionist approach with the interpretive, phenomenology and the tradition associated with dialectical hermeneutics.

4.3.2 CLARIFYING THE TERMS

The family of terms in the phrase needs to be defined.

Epiphanic The moment of problematic event/experience that signifies a turning point or change in a subject's life.

Interpretive To explain the meaning of; the act of interpreting, or conferring meaning to a text, event, phenomena or interaction.

Symbolic For human beings, the mode of interaction is symbolic, mediated by the use of language and symbols.

Interactionism Symbolically taking the perspective of the subject and interacting on that perspective in a dialectical manner; such interaction is always emergent.

The above terms are specially chosen to highlight the underlying critical methodological ethos flowing throughout this research. It seeks to interpret the text and trace moments of shifts in the level of auditor responsibility towards fraud detection over time. It is argued that these shifts (under the imposing authority of statute law) do take effect immediately when the law is passed and this creates a series of epiphanic disjointed steps of change in contrast with a smooth continuum. The concept of the epiphany will be expanded a bit more in the next section.

The interpretive mode has to be continuously applied due to the dual subjective dimensions chosen for this research. Firstly, of statute law, in trying to ascertain the definitional meaning of an indeterminate statutory provision and secondly, in attempting to confer sociological meaning to those epiphanic statutory provisions. Such a prior deciphering mode is crucial since one acts on the basis of the meanings yielded by the interpretation of texts.

The medium through which communication is transmitted, received, symbolically processed, understood, interpreted and acted upon is through language (written, oral, sign, touch, body). As this is a historical study, the medium used will be language documented in the archival material, both in its primary and secondary form. Moreover, human beings live in a symbolic environment as well as a physical environment and can be 'stimulated' to act by symbols as well as by physical stimuli (Rose, 1962). The auditor is 'stimulated' to act by the statutory symbols.

This world is socially produced in that the meanings are fabricated through the process of social interaction. This production is even fabricated to the epistemological level where the researcher has to dialectically interact with the symbols to get to the heart of

the text and its changing process and movement. Also different groups come to develop different worlds - and these worlds change as the objects that compose them change in meaning. Since people are set to act in terms of the meanings of their objects, the world of objects of a group represents in a genuine sense its action and reaction. To identify and understand the duties of the auditor, it is necessary to identify its world of objects (be it statute law, case law, professional pronouncements, etc) and this identification has to be in terms of the meanings the objects have for the auditors. Essentially this research is concerned with the meanings which underlie the process of interaction and is an attempt to understand the role of the auditor in these terms.

Combining the two terms, Blumer (1966) drew the distinction between 'non-symbolic' and 'symbolic' interaction.

"In non-symbolic interaction human beings respond directly to one another's gestures or actions; in symbolic interaction they interpret each other's gestures and act on the basis of the meaning yielded by the interpretation. An unwitting response to the tone of another's voice illustrates non-symbolic interaction. Interpreting the shaking of a fist as signifying that a person is preparing to attack illustrates symbolic interaction."
(p537-8)

This research is concerned predominantly with symbolic interaction. Blumer (1966) stresses that it involves 'definition' or conveying indications to another person as to how he is to act and 'interpretation' or ascertaining the meaning of the symbols behind the statutory text. Human association consists of such a dual process of definition and interaction.

Combining these terms, Epiphanic Interpretive Symbolic Interactionism (EISI) is a mode of interpreting problematic turning point experiences involving symbolic interaction between the subject matter and the researcher in a dialogic manner.

4.3.3 EISI AND THE EPIPHANY

As a distinctly qualitative approach to social research, EISI attempts to make the world of lived experience directly accessible to the reader. The focus of EISI is on those events that do alter and shape the meanings people give to themselves and their roles. This existential thrust (Sartre, 1956) sets the research apart from some of the other interpretive approaches that examine the more surface level mundane taken for granted

properties and features of everyday life (Garfinkel 1967, Goffman 1974, Johnson 1977). By looking on the surface level, effects are barely felt. They are often taken for granted and are non-problematic. Effects at the deep level cut into the inner core of the subject's life and leave indelible marks on them.

It leads to a focus on the concept of the epiphany which is developed further here. It is described by Denzin (1989) as the moment of problematic experience that illuminates personal character and often signifies a turning point in the subject's life, leaving indelibly negative and positive marks behind.

These interactional moments that leave marks on people's lives have the potential of creating transformational experiences for the person. They become notandums. In them, crises or points of change are manifested and made apparent. By recording these events in detail, the researcher is able to trace the moments of change that occur in the subject's life. They are often interpreted, both by the subject and by others, as turning point experiences (Strauss, 1959). EISl seeks to produce and interpret records like this. Such an interpretive method rests on the collection and analysis of stories, accounts, discourses and narratives as temporal mappings (Culler 1981, Ricoeur 1985) that speak to turning point moments in people's lives.

Consider the following excerpt from Dostoyevsky's (1950) description of Raskolnikov's act of murder in *Crime and Punishment*.

"His hands were fearfully weak, he felt them every moment growing more numb and more wooden. He was afraid he would let the axe slip and fall...A sudden giddiness came over him...He had not a minute more to lose. He pulled the axe quite out, swung it with both arms, scarcely conscious of himself and almost without effort, almost mechanically, brought the blunt side down on her head...The old woman was...so short, the blow fell on top of her skull. She cried out, but very faintly...he dealt her another blow...the blood gushed as from an overturned glass...He stepped back...trying all the time not to get smeared by the blood."

(p71)

In this account, which is rich in descriptive detail, Dostoyevsky brings alive the moment of Raskolnikov's crime of murder, the epiphany. He describes the thought and feelings of Raskolnikov as he acted. He describes the act in detail and brings the reader into the sub-epiphanies. The remainder of Dostoyevsky's novel deals with the meanings of this crime for Raskolnikov.

Epiphanies occur within the larger historical, institutional and cultural arenas that surround a subject's life. The interpretive scholar seeks as C W Mills (1959) observed to understand the larger historical scene in terms of its meaning for the inner self and the external life of a variety of individuals. This requires the researcher to connect progressively from a mini to a micro and henceforth to a macro level.

Now consider the following moment in; the life of the former Guinness Chairman Ernest Saunders. On 29 August 1990, D John reported that Saunders received a five year jail sentence after being found guilty of two charges of stealing £8 million. He was also sentenced to 3½ years to run concurrently after being convicted on eight charges of false accounting and two offences of conspiracy. The epiphanic verdict of guilty by the 11 jurors and the sentence passed by the judge in Southwark Crown Courts will be regarded by Saunders as the transforming event, one that he would always think back in future years when the pressures in the prison seem to be too great.

The epiphany manifests itself in those problematic interactional situations where the subject confronts and experiences a crises in the event of change of circumstances. It has transformed Saunders' life of wealth and power to that of disgrace, divorce, a destroyed career and loss of freedom. The epiphany has occurred within the larger historical, institutional and cultural arenas of take-over bids, financing, deterrence and prosecution.

But let us come back to the concept of the epiphany. The first characteristic of epiphanic thinking is that it places all the emphasis on change. Instead of talking about static structures, it talks about process and movement. Hence, it is in line with those who say, *"Let's not be deceived by what is, let's not pretend we can fix it, and label it and turn it into a rigid thing, but let's look at how it changes"*.

And the second characteristic which sets it apart from any philosophy which emphasises smooth continuous change or progress, is that it states that the way change takes place is through discontinuity or conflict or opposition.

Discontinuity is a term which is much associated with Foucault's work [*Discipline and Punish* (1973), *The History of Sexuality* (1978)]. Foucault does not narrate the evolution of the past; he does not claim that in every historical event there must be a

causal connection or a full understanding of it or as determining the present. Hence he avoids the question 'why'. In short, Foucault is not a historian of continuity but discontinuity. He labours to distance the past from the present, to disrupt the easy, cosy intimacy that historians have traditionally enjoyed in the neat and closed relationship of the past to the present. The remarkable achievement of Foucault's Nietzschean discourse is that it captures the past without justifying the present.

Philp (1988) states that the 'course' of history or the narrative of human agency from past to present is an illusion. Foucault also attacks this progressive view of history. It was noted by Goldstein (1984) that Foucault shows lack of interest in studying historical periods in the traditional way.

Instead of claiming totalisation of knowledge/explanations, Foucault proposes a multiplicity of forces in any social formation, a multiplicity which Poster (1985) saw as dispersed, discontinuous and unsynchronised. Social theory for him cannot grasp an entire social formation in one key concept or schema. It must rather explore each discourse/practice separately, unpacking its layers, decoding its meanings, tracing its development wherever its meandering path may lead. Foucault is an ardent detotaliser, preferring a syncopated approach which never pretends to capture the whole of any historical moment, a noble aspect of intellectual honesty. He goes so far in this direction as to acknowledge in some places that he is a pluralist (Foucault, 1972).

Poster (1985) saw the maturation of the historian as one who acquires a taste for the past as a penchant for what is different. Foucault has referred to this notion of difference as discontinuity. The researcher has equated discontinuity with the epiphany. In this study the epiphanies represent the turning points for the auditor, in terms of their changing statutory role towards fraud detection.

4.4 THE EISI PROCESS

There are six phases or steps in the EISI process. They are stated as follows:

- 1) Framing
- 2) Contextualisation

- 3) Capture
- 4) Bracketing
- 5) Construction
- 6) Consolidation

An explanation of each of these steps is as follows.

4.4.1 FRAMING

Understanding can be seen as a fusion of two perspectives: that of the researcher, located in his own life (in a larger culture and in an historical point in time) and that of the subject itself - be it an ancient text, the life of an historical figure, or a current/historical social or psychological event or process.

The research questions are thus framed by the two sources: the researcher and the subject.

This world does not stand still, nor will it confirm to the researcher's logical schemes of analysis. It contains its own dialectic and its own internal logic. In other words, the world does not stand independent of perception or observer organisation. In these respects, the interpretivist researcher with the sociological imagination uses his life experiences as topics of enquiry (Denzin, 1989). For then, the researcher works outwards from his own biographies; from the perspective of the researcher's home discipline. Unlike the positivists who separate themselves from the worlds they study, the interpretivists 'participate' in the social world so as to understand and express more effectively its emergent properties and features.

Mills (1959) states this position in the following words:

"The most admirable thinkers within the scholarly community...do not split their work from their lives...what this means is that you must learn to use your life experiences in your intellectual work."

(p195-6)

The researcher has been a professional auditor himself for some time and is deeply interested on issues facing the auditor in practice. Hence the auditing world represents the researcher's own world of experience.

EISI asserts that meaningful interpretations of human experience come mainly from those persons who have immersed themselves in the phenomenon they wish to understand and interpret. There is as Merleau-Ponty (1973) argued, an inherent indeterminateness in the worlds of experience. Life experiences give greater substance and depth to the problem the researcher wishes to study.

The researcher is then led to seek out subjects which echo the types of experiential concern that the researcher seeks to understand. The chosen subject in the interpretive study elaborates and further defines the problem that organises research. The subject chosen is a topical one, namely that of the extent of the auditor's role or duty towards fraud detection. Is the auditor fully responsible for failure to detect fraud? Is it any fraud or restricted to material fraud only? Or is that a blanket responsibility over time?

Given this interpretation of the subject and its relationship to the research question, the task of conceptualising the phenomenon to be studied is then given. The researcher seeks to uncover how the problematic acts, or events, in question organises and gives meaning to the subject studied. What does it imply from the facts of the phenomenon?

The question that is framed becomes a 'how' question. Interpretive research addresses the 'how', not so much the 'why' questions (Denzin, 1989). As argued earlier, interpretive studies examine how problematic turning point experiences are organised, perceived, constructed and given meaning by interacting individuals. It assumes that the answer to a 'how' question will contain native or subject interpretations and could possibly turn up some of the explanations concerning 'why' a certain experience/event happened. EISI attempts to uncover the reasons and the meanings people bring to the turning point moments in their lives.

As this is a historical study, the 'how' question needs to be preceded by two questions before it can be answered. They are as follows:

- a) When and where did those duties emerge?

b) What was the extent of those duties?

Only then, can the third question be dealt with appropriately.

c) How did the duties come about?

The questions are consistent with the research objectives mentioned in section 2.6 and also with Blumer's philosophy of symbolic interactionism on having the dual theory of definition and interpretation. The respective questions thus provide the first order (H₁), second order (H₂) and third order (H₃) of the historical study (H = historical).

4.4.2 CONTEXTUALISATION

In *The Idea of History*, Collingwood (1961) maintains throughout that all understanding is contextual. Schutz (1967) argues that the stock of knowledge on which we use to typify the actions of others and understand the world around us varies from context to context. We live in a world of multiple realities each of which is defined in terms of 'provinces of meaning'. Nothing can be understood meaningfully in isolation (Boucher, 1989). It refines the boundaries for examination and re-examination.

Contextualisation begins with the essential themes and structures mapped out in framing. It attempts to interpret those structures and give the meaning by relocating them back into the phenomena of the subject being studied. Contextualisation takes what has been learned about the phenomena through the background information and fits that knowledge in a contextual siting to the social world where it occurs. It brings the phenomenon alive in the worlds of interacting auditors by locating the contextual phenomenon in the biographies and social environments of the subject being studied. It isolates the meanings for them and presents it in their terms, in their language and in their tones (Denzin, 1989).

From Chapter 2, it was seen that the auditor's duty is dictated by the law (statute and case law) and professional guidance (auditing and ethics). Statute law is then categorised into company law and financial services. The vastness (in terms of depth and breadth) of each of these categories merit a separate research study on its own. This research is not intended nor is it feasible to cover all the aspects above but to concentrate rigorously on the impact of company law on the auditor's duty towards

fraud detection. The company law context is chosen because of its long historical roots going back to 1844, its authoritative status (above case law and professional pronouncements) and its pervasive influence on the vast number of registered companies (in contrast with investment businesses). The year 1844 represents the first Companies Act which required a mandatory statutory audit. Also since 1844, it has been possible for business organisations to achieve corporate status simply by registering under the Companies Acts. Before 1844, incorporation could be achieved only by means of a Royal Charter or an Act of Parliament. The latest Companies Act is in 1989. This research is thus undertaken in the context of the statutory audit of companies incorporated under the Companies Acts. It excludes statutory companies and railway companies (and the relevant Companies Acts) which are not incorporated by registration. Hence it is a very significant context on which to focus. The framed questions can now be refined further in the light of this chosen context.

Hence, the intent of contextualisation is to bring into a specific and sharper focus on the phenomenon or subject under investigation. The goal is to create a contextual body of materials that will furnish the foundations for interpretation and understanding. When we seek to interpret in a context, we are trying to make more precise our comprehension of some specific and delimited area and becoming more exact about what is known. By doing so, contextualisation anchors and contains the accounts of problematic meanings in the relational world of the subject. Contextualisation seeks to focus on how all these occur specifically, and lays the groundwork for the next step of EISI, which is capture.

4.4.3 CAPTURE

Almost all research projects involve the gathering of data. This is no exception. After the context has been set, the researcher is led to gather information/discourses which address the first framed question in context. It seeks to obtain relevant data that embody the essential features of the phenomena as constituted in the framing stage. In doing so, one is scanning for data which addresses the H₁ question: When and where did the auditor's statutory duties emerge under the Companies Acts 1844-1989?

As mentioned earlier, H₁ refers to the 'first order' of study. It is classified as the 'substantive philosophy of history' in the form of verifiable historical facts. It leads to the historian's subject matter in a systematic chronological order. For, after all, one

cannot begin H₂ with a totally blank piece of paper. The essence of history lies in the fact that by definition there needs to be a chronological guiding thread locating events in space and time. Elton (1967) argues that history deals with datable events, which Atkinson (1978) further adds, as having beginnings and ends in time, even if not very sharp ones.

Leff (1969) follows the same argument as Elton in maintaining that no statement is historical unless it is time-specific, that is, unless it captures the events or situations it refers to in time. It is in line with the first of Collingwood's (1961) supposed rules of historical 'method', the rule, namely, that historical 'pictures' must be located in space and time. The other two rules are that history should be self-consistent and in accordance with evidence. The rules are in fact clearly constitutive, not regulative as the word 'method' misleadingly suggests. They do not prescribe how historians should conduct their enquiries; they rather define, or help to define, what is to count as history. Collingwood (1965) actually recognised this himself, when he wrote:

"The so-called rules of the [historical] game are really the definition of what historical thinking is"

(p98)

Atkinson (1978) stated that an author who was not trying to date events, to be consistent, to follow the evidence would not be functioning as an historian. He would be failing to engage in the practice of history in the sort of way that people building with cards or dominoes are failing to play the games in question.

Having completed the capture stage, the next phase of EISI is bracketing.

4.4.4 BRACKETING

Bracketing is a terminology borrowed from Husserl (1962). In bracketing, the researcher holds the phenomenon up for more detailed inspection. It is removed from the world where it occurs, taken apart and dissected. In doing so, its elements and essential structures are uncovered, defined and analysed. Bracketing is concerned not solely nor primarily with what the documents say, but also with what they show about those who wrote and first read them and about the situations in which they were produced. As Bloch (1985) put it, more can be learnt from the documents than their authors intended to tell.

Bracketing treats a text or a document on its own which involves two main steps; namely subdividing the text into key units (the brackets) and the definitional interpretation of each unit. It is not interpreted only in terms of the standard meanings given to it by the existing literature. Such preconceptions are suspended and put aside during bracketing. In bracketing the subject matter is confronted as much as possible on its own terms. Faberman (1980) even goes on to assert that it is the process surrounding the autonomisation of signs; signs that stand for and refer to nothing but themselves.

One strategy that assists in bracketing is the use of semiotics to signify the structures that need to be read. It comes under the umbrella of content analysis. Content analysis is defined by Krippendorff (1980) as a research technique for making replicable and valid inferences from data to their context. He adds that it could be characterised as a method of inquiry into symbolic meanings of words used.

Semiotics is a technique of content analysis for reading the meaning of words and signs within narrative and interactional texts (Saussure 1959, Barthes 1972, Denzin 1987, Manning 1987). A semiotic reading would identify the dominant meanings and codes in the text, and then perform a subversive or critical reading of the text helping to expose in the process its underlying values and meanings. It suggests that these terms or signs are organised by a code or set of rules for definitional interpretation which provides a system of larger and deeper meanings. The meaning of a text unfolds as it is being defined and interpreted.

At this stage, interpretive methodologists will be involved in learning and grasping what Denzin (1989) calls the double structure that is embedded in language. They learn the language that is 'spoken' by those they study, ie learning the possible uses to which that language can be put.

In addition, they will be reading and decoding that language once it takes the shape of a context on which the researcher intends to focus. Words in a sentence have to be understood in terms of their typological study. Whilst one can attribute a particular meaning to words on their own account, they may assume a different meaning in the context of other worlds. So it is with social phenomena. Language in this sense is the

gateway into the inner interpretive structures of the subjects that are being studied (Dougherty, 1985).

A semiotic reading works from part to whole and from whole to part: from the bracketed to the unbracketed and vice-versa. It uncovers the codes that organise a text's meanings and subsequently leads to the examination of the forces that structure its meaning. It draws attention to the multiple meanings of bracketed key words within interactional and narrative texts. It asks the researcher to perform both static, dynamic and processual readings of texts. Such a semiotic framework would simply have made these definitional interpretations more explicit.

Semiotics thus occupies a central mediating place in interpretive symbolic interactionism. It is of much surprise that both Harman (1986) and MacCannell (1986) commented that with few exceptions (MacCannell 1976, Perinbanayagam 1985), semiotic theory has remained outside much symbolic interactionist discourse.

Bracketing thus represents the 'second order' of study: H_2 . It is classified as the 'analytical philosophy of history' since it analyses the key words/units for definitional meanings. It is the study and interpretation of the meanings of the subject matter located in H_1 . The H_2 process is categorised as the 'mini stage'. H_2 leads us to the next stage of EISI: construction.

4.4.5 CONSTRUCTION

Construction builds on bracketing. It classifies, orders and reassembles the phenomenon back together in terms of its essential parts, pieces and structures into a coherent whole. It involves securing multiple cases that embody the phenomenon in question, categorising the cases, mapping out the transformations and thus locating the turning points and epiphanies for the auditor.

If bracketing takes something apart, construction puts it back together. It records the range of interpretations that could be made by those involved in the interaction as interaction unfolds and takes the reader *"to the heart of what is being interpreted"* (Geertz, 1973 p18).

The researcher in the phase of construction, endeavours to gather the lived experiences/events in terms of its constituent, analytic elements that relate to and define the phenomenon under study which subsequently coalesces into a macro frame. A coherent interpretation includes relevant information and prior understandings. It is based on materials that are historical, relational, processual and interactional (Denzin, 1989).

Such a micro stage constructs a system of analysis and understanding that is meaningful within the worlds of historical phenomena to the persons studied, the researcher and the reader. It assumes that any experience has meaning at two levels: the surface (obvious) and the deep (unobvious) (Freud, 1965). Meaning which must be captured in interpretation is symbolic. It moves in surface and deep directions at the same time and one attempts to unravel, record and construct these multiple meaning structures. It assumes that multiple meanings will always be present in any situation. No experience must have the same meaning for two individuals. This is so because the derivation of meaning is emergent and biographical (Denzin, 1989).

In construction, the first part of the 'third order study' (H_{3a}) is explored. H₃ is classified as the 'interpretive philosophy of history' since it seeks to interpret and provide some explanations and meanings for the constructed mappings. An attempt at the 'how possibly' (necessary conditions) is made here at the micro level. Hence this H_{3a} process is referred to as the 'micro stage'.

Construction thus reassembles each of the 'rules' of bracketing in a chronological manner, indicating how each builds on and influences the other. This lays the groundwork for the last phase of the EISI process, consolidation.

4.4.6 CONSOLIDATION

In the final stage of EISI, one consolidates the individual typologies of constructed data to cohere into a 'totality'. By doing so it is hoped that it will provide an overview albeit a somewhat loose one of how each typology affects and relates to the others.

Such information may elaborate and further sub-refine the H₃ question. It will also create a body of materials that will furnish the foundations for further interpretation and understanding of the interaction and experiences that go on within them. The

researcher seeks to gain access to such settings and secures further texts, biographies, experienced narratives and journalistic records about the events in question to discern the actions and meanings of such interaction.

The world of lived experience is shaped by micro understandings and texts. These texts often give meaning to problematic experiences. But such texts exist within the larger macro cultural, political and ideological contexts (Barthes, 1967). Accordingly, a necessary step in any interpretive study is that the researcher adopts a macro view to the contextual problematic experiences/events being studied and seeks to record the significant social relationships that exist between the typologies being studied. In the earlier micro stage, the materials were only presented temporally as ongoing non-interactive slices.

In consolidation, the second part of the third order of study (H_{3b}) is carried out. It seeks to further interpret and explain the consolidated mappings and transformations on a macro level. Hence, the reference to it being the 'macro stage'.

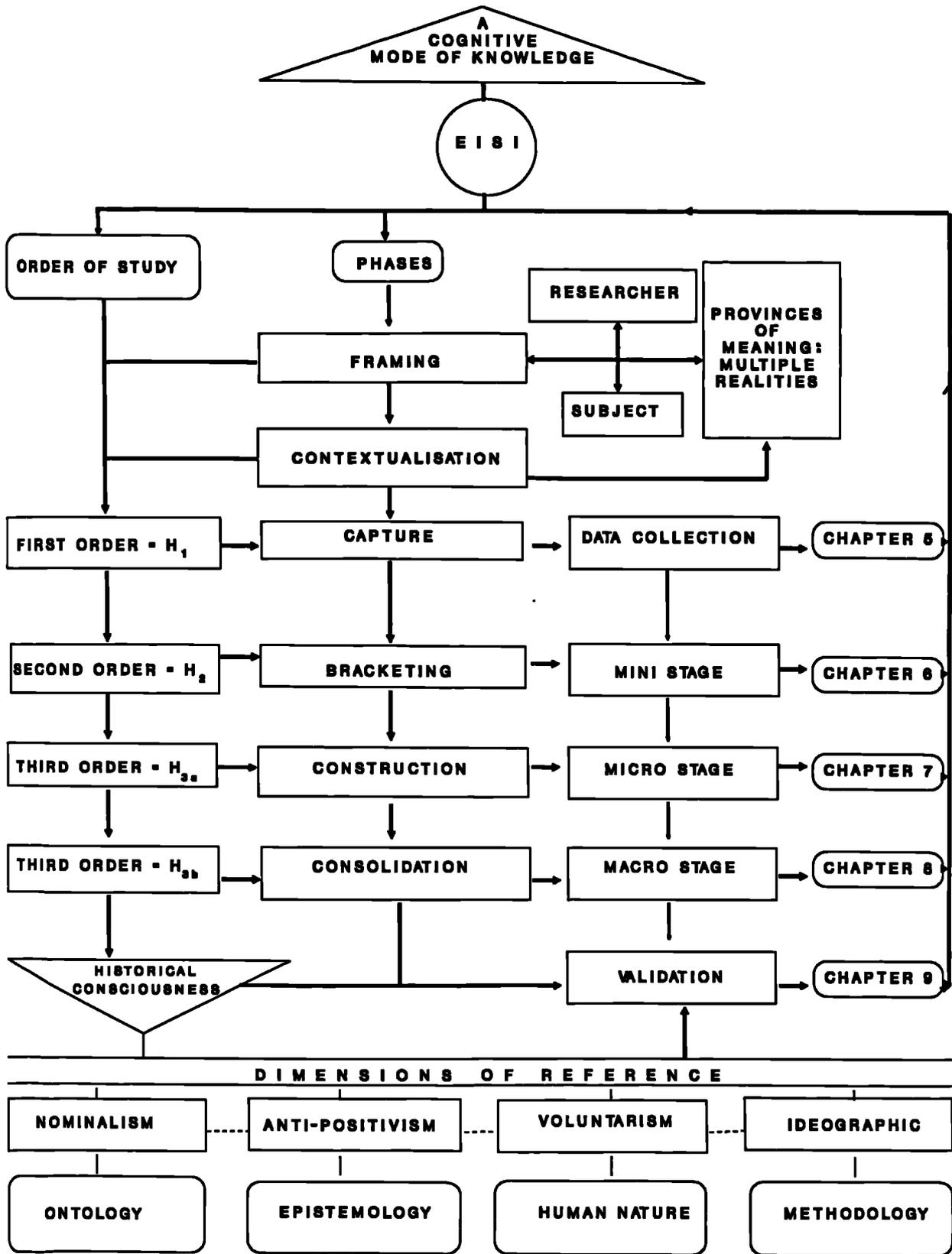
Sensitizing the constructed data this way permits the researcher to discover what is unique about each typological instance of the construction while he uncovers what it displays in common across many different settings. Such a conception allows, indeed forces, the researcher to pursue his interactionist view of 'reality' to the empirical extreme.

4.5 DIAGRAMMATIC SUMMARY OF EISI

Figure 4.3 summarises the EISI process. It provides the overview of the methodological framework: EISI.

According to Forster (1990), the principal task of study is a perception into 'a reality' of a given situation. One can go through a major crisis, for example, the Gulf Crisis without any perception of the real nature of the tragic situation. But if one carefully, systematically and rigorously observes and reviews what has occurred, one can move to a much deeper level of uncharted historical consciousness.

Figure 4.3 : DIAGRAMMATIC SUMMARY OF EISI



4.6 ENVOI

The interpretive perspective is deliberately non-positivistic or post-positivist (Lincoln and Guba, 1985). ESI is founded on the study, expression and interpretation of subjective social phenomena. It rejects causal modes and methods of causal analysis. The exclusive search for causal 'whys', causal paths, causal chains and causal antecedents is detrimental to the study and understanding of directly lived experience (Denzin, 1989). The 'why' question is replaced by the 'how' question. That is, 'how' is social experience or a sequence of social interaction, organised, perceived and constructed by interacting subjects or events?

Interpretive studies are organised in terms of a biographically meaningful event or moment, in a subject's life. The event, how it is experienced, how it is defined, and how it is woven through the multiple strands of the subject's life, constitutes the focus of this research.

Human experiences are meaningful, both for those involved in them and also for those who study them systematically. Frankl (1969) saw the loss of meaning in life as a basic threat to a person's continued being in this world. Research of this order it is hoped, will produce meaningful descriptions and interpretations of social processes; it can offer explanations of how certain conditions came into existence and persisted. The interpretive researcher 'participates' in the social world so as to understand and express more effectively its emergent properties and features.

ESI aims, as much as possible, for a concept-free mode of discourse and expression. Such a rendering assumes that the streams of situations and experience that make up everyday life will not submit to experimental, statistical, comparative or causal control and manipulation. Every human situation is novel, emergent and filled with multiple, often conflicting meanings and interpretations (Denzin, 1989). The interpretivist attempts to expose the core of some of these meanings and contradictions.

The slices, sequences and instances of social interaction that are studied by the interpretivist carry layers of meaning, nuance, substance and fabric; and these layers can come in multiples and may be contradictory. Like a novelist or painter, the interpretivist moves the reader dialectically back and forth across the text of his prose or paintwork. In so doing, the researcher makes recognisable and visible a slice of the

human events that have been captured (Sudnow, 1979). Rather, such knowledge reflects interpretive structures, emotionality and power relations that permeate the situations being investigated. As a consequence, interpretive studies seek to reveal the interpreted worlds of interacting social events.

Interpretive studies seek to illuminate the phenomenon in a contextualised manner, so as to reveal the historical, relational, processual and interactional features of the event under study. Interpretation must engulf what is learned about the phenomenon and incorporate prior understandings while always remaining incomplete and unfinished.

Under the positivist paradigm, qualitative, applied and evaluative knowledge are assumed to be objectively valid. The making sense phase of human inquiry is seen as an attempt to kill the data by setting out a list of hypothesis and shooting each one with a yes or no (Reason and Rowan, 1987). Once obtained, such 'complete and finished' knowledge is then assumed to have a real force and relevance in the applied social world. Under the interpretive paradigm, knowledge can be assumed neither to be objective nor to be valid in any objective sense. In fact, some of the explanations are only conjectures or speculations.

In one sense, interpretive studies hope to understand the subject better than they understand themselves (Dilthey, 1976). Often interpretations are formed that subjects would not give to their actions. This is so because the researcher is often in a position to stand back and see things that the subject cannot see: the myopic effect.

In summary, Epiphanic Interpretive Symbolic Interactionism interprets and render understandable turning point transformations within a contextual frame in the lives of the subjects and events studied. It is not enough just to describe but rather an exposition of the definitions, interpretations and explanations produced and conveyed to the reader.

Kockelmans (1975) saw tradition or history as something which is not to be transcended but to be taken up in such a manner that by giving us access to our past, it continually opens up new possibilities for the future.

Having applied EISI to the contextualisation step in this chapter, we now move to apply the next step by capturing data in the next chapter.

CHAPTER 5

DATA COLLECTION

5.0 PRELUDE

"There was once a man who lived in a country which had no fruit trees. This man was a scholar and spent a great deal of time reading. In his readings he often came across references to fruit. The descriptions of fruit were so exciting that he decided to undertake a journey so that he could experience fruit for himself.

He went to the market and asked everyone he met if they knew where he would find fruit. After much searching, he located a man who knew the direction to the country and place where he could find fruit. The man drew out elaborate directions for the scholar to follow.

With his map in hand, the scholar carefully followed all of the directions. He was very careful to make all of the right turns and to check out all of the landmarks that he was supposed to observe. Finally he came to the end of the directions and found himself at the entrance to a large apple orchard. It was spring time and the apple trees were in blossom.

The scholar entered the orchard and proceeded immediately to take one of the blossoms and tasted it. He liked neither the texture of the flower nor the taste. He went to another tree and sampled another blossom, and then another blossom, and another.

Each blossom, though quite beautiful, was distasteful to him. He left the orchard and returned to his home country, reporting to his fellow villagers that fruit was a much overrated food."

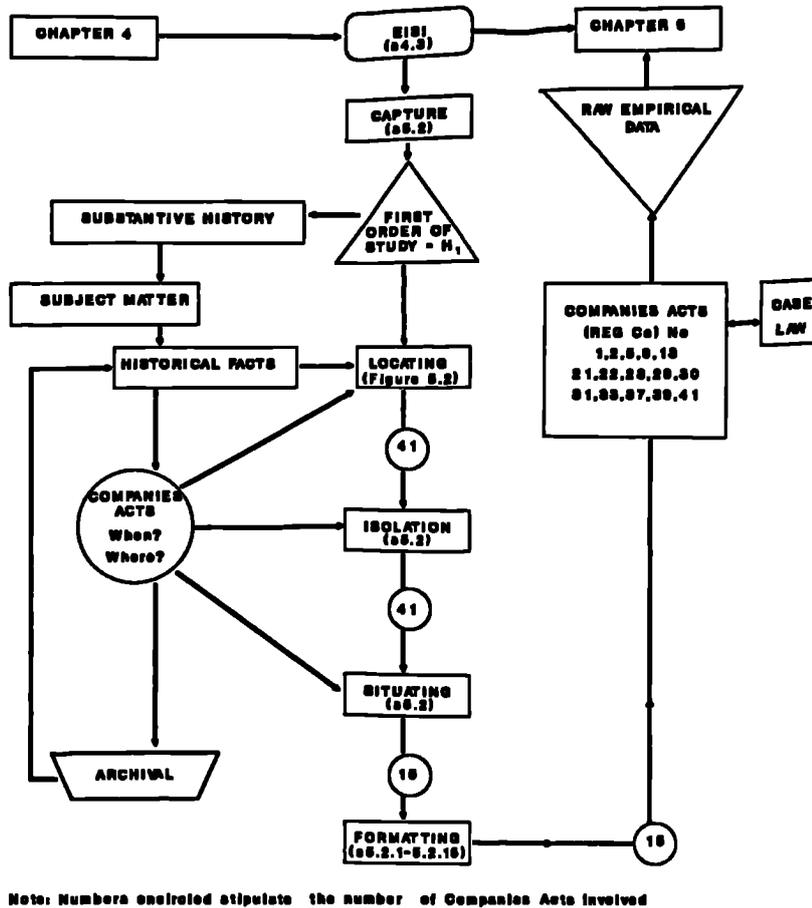
Extracted from Patton (1980), p21

5.1 INTRODUCTION

This chapter seeks to carry out the capture stage of EISI or the first order of study H_1 mentioned in the previous chapter. Capturing the phenomenon or subject matter involves ascertaining the substance of the historical or archival material from which the subject matter and the historical facts can be studied as shown in Figure 5.1. Questions of 'when' and 'where' guide the capture stage.

It begins by locating all the Companies Acts since 1844; 'the country and place where he could find fruit'. This is summarised in Figure 5.2.

Figure 5.1 : FRAMEWORK OF CHAPTER 5



The statutory provisions in each of the Companies Act were thoroughly searched to isolate those sections relating to the auditor's duties. For capture involves securing multiple cases that embody the phenomenon in question.

It was found that not all the Companies Acts located were relevant. The relevant Companies Acts were then singled out for situation. The data obtained here so far is raw empirical data: the blossoms of the fruit, not the fruit itself. It is then presented in an appropriate format for the analysis in the next chapter.

5.2 CAPTURE

The context chosen for this study is company law, in particular all the Companies Acts for registered companies since 1844. This was extracted from a detailed list of British Companies Acts for registered companies since 1719, prepared by Edwards (1980). In order to ensure that the list was adequate and comprehensive, reference was also made to the 1988 *Halsbury's Laws of England* which also provided a historical list of company law statutes. The results are summarised in the Figure 5'2 below.

Figure 5'2 : SUMMARY OF BRITISH COMPANIES ACTS : REGISTERED COMPANIES (SINCE 1844)

COMPANIES ACT (REG Co) No	SHORT TITLE	CITATION
1	JOINT STOCK COMPANIES ACT 1844	7&8 VICT c 110
2	JOINT STOCK BANKS ACT 1844	7&8 VICT c 113
3	JOINT STOCK COMPANIES (AMENDMENT) ACT 1847	10&11 VICT c 78
4	LIMITED LIABILITY ACT 1855	18&19 VICT c 133
5	JOINT STOCK COMPANIES ACT 1856	19&20 VICT c 47
6	JOINT STOCK BANKING COMPANIES ACT 1857	20&21 VICT c 49
7	JOINT STOCK COMPANIES AMENDMENT ACT 1858	21&22 VICT c 60
8	JOINT STOCK BANKS ACT 1858	21&22 VICT c 91
9	COMPANIES ACT 1862	25&26 VICT c 89
10	COMPANIES (SEALS) ACT 1864	27&28 VICT c 19
11	COMPANIES ACT 1867	30&31 VICT c 131
12	COMPANIES ACT 1877	40&41 VICT c 28
13	COMPANIES ACT 1879	42&43 VICT c 76
14	COMPANIES ACT 1880	43&44 VICT c 19
15	COMPANIES (COLONIAL REGISTERS) ACT 1883	46&47 VICT c 30
16	COMPANIES ACT 1886	49&50 VICT c 23
17	COMPANIES ACT (MEMORANDUM OF ASSOCIATION) 1890	53&54 VICT c 62
18	COMPANIES (WINDING UP) ACT 1890	53&54 VICT c 63
19	COMPANIES (WINDING UP) ACT 1893	56&57 VICT c 58
20	COMPANIES ACT 1898	61&62 VICT c 28
21	COMPANIES ACT 1900	63&64 VICT c 48
22	COMPANIES ACT 1907	7 EDW 7 c 50
23	COMPANIES (CONSOLIDATION) ACT 1908	8 EDW 7 c 69
24	COMPANIES (CONVERTED SOCIETIES) ACT 1910	10 EDW 7 + 1 GEO 5 c 23
25	COMPANIES ACT 1913	3&4 GEO 5 c 25
26	COMPANIES (FOREIGN INTERESTS) ACT 1917	7&8 GEO 5 c 18
27	COMPANIES (PARTICULARS AS TO DIRECTORS) ACT 1917	7&8 GEO 5 c 28
28	COMPANIES ACT 1928	18&19 GEO 5 c 45
29	COMPANIES ACT 1929	19&20 GEO 5 c 23
30	COMPANIES ACT 1947	10&11 GEO 6 c 47
31	COMPANIES ACT 1948	11&12 GEO 6 c 38
32	COMPANIES (FLOATING CHARGES) (SCOTLAND) ACT 1961	9&10 ELIZ 2 c 46
33	COMPANIES ACT 1967	15&16 ELIZ 2 c 81
34	COMPANIES (FLOATING CHARGES) (SCOTLAND) ACT 1972	20&21 ELIZ 2 c 67
35	COMPANIES ACT 1976	24&25 ELIZ 2 c 69
36	COMPANIES ACT 1980	28&29 ELIZ 2 c 22
37	COMPANIES ACT 1988	29&30 ELIZ 2 c 62
38	COMPANIES (BENEFICIAL INTERESTS) ACT 1983	31&32 ELIZ 2 c 50
39	COMPANIES ACT 1985	33&34 ELIZ 2 c 6
40	COMPANIES CONSOLIDATION (CONSEQUENTIAL PROVISIONS) ACT 1985	33&34 ELIZ 2 c 9
41	COMPANIES ACT 1989	36&37 ELIZ 2 c 40

For each of these Companies Acts, a systematic reading was carried out for any statutory provisions which spell out the auditor's duties. It would involve taking up each Companies Act and scanning through page by page for the marginal notes (subject matter) pertaining to the audit. The marginal notes provide a short explanation of the content of that section. The relevant sections dealing in particular with the auditor's duties can then be situated. It is only with the later Acts of this century that there was an Arrangement of Sections (a contents section) at the commencement of the Act which provided a summary of the marginal notes. This did help to make the isolation process a bit less laborious, without requiring to scan through the whole Act itself. It was found that 15 of the Companies Acts (Nos 1, 2, 5, 9, 13, 21, 22, 23, 29, 30, 31, 33, 37, 39, 41) had relevant sections pertaining to the auditor's duties.

The next stage was to document the relevant Companies Acts in a suitable manner for subsequent analysis. It presents the relevant statutory provisions as they are. This permits the researcher to compare and contrast the relevant provisions of the various statutes located at different points in time. Multiple events like this allow convergences to be identified. For each Companies Act, the Companies Act number was stated followed by the official citation for the statute (regnal year and chapter), short title, long title (purpose of act), relevant statutory sections containing the rule of law, subject matter of relevant section, actual wording of sections and case law to relevant sections. This is based on the guidelines set by Bradney et al (1991).

On the last item, it was found that there were case law which the judges actually discussed the meaning of the relevant statutory sections. The list of case law was obtained with the aid of *The All England Law Report : Consolidated Tables and Index 1936-1989 vol 1 : Statutes Considered (Companies Acts)*, *The Law Reports Index Digest : Statutes Judicially Considered*, *Chitty's Statutes (5th ed) vol II: Companies Section* by Lely (1894) and the LEXIS Computer Search. All the situated details are then formatted in the following sections.

There exists other case law on the auditor's duties which have been developed without specific reference to statute law, such as the *Kingston Cotton Mill (1896) 2 Ch 279* case. Hence, this study has not focussed on this 'other case law' though brief references will be made. Moreover, the scope of this 'other case law' is so wide that it merits a separate study on its own.

5.2.1 COMPANIES ACT (REG Co) No 1

CITATION 7&8 VICT c 110

SHORT TITLE Joint Stock Companies Act 1844

LONG TITLE An act for the registration, incorporation, and registration of joint stock companies (excluding banking co)

RELEVANT SECTION(S) a) s38

b) s41

SUBJECT MATTER a) Appointment of auditors by company

b) Report by auditors (auditors' duty)

WORDING OF SECTION(S) a) *"And be it exacted, that every joint stock company completely registered under this Act shall annually at a General Meeting appoint one or more Auditors of the Accounts of the Company"*

b) *"And be it exacted, that within fourteen days after the receipt of such Balance Sheet and Accounts, the Auditors shall either confirm such Accounts, and report generally thereon, or shall, if they do not see proper to confirm such Accounts, report specially thereon, and deliver such Accounts and Balance Sheet to the Directors of the Company."*

CASE LAW TO None

RELEVANT

SECTION(S)

5.2.2 COMPANIES ACT (REG Co) No 2

CITATION 7&8 VICT c 113

SHORT TITLE Joint Stock Banks Act 1844

LONG TITLE An act to regulate joint stock banks in England

RELEVANT s4

SECTION(S)

SUBJECT Deed of settlement

MATTER

WORDING OF SECTION(S) *"And be it enacted, that the deed of partnership of every such Banking Company shall...contain specific provisions for the following purposes:*

Seventh, for the yearly audit of the accounts of the company by two or more auditors chosen at a General Meeting of the Shareholders, and not being Directors at the time."

CASE LAW TO None

RELEVANT

SECTION(S)

5.2.3 COMPANIES ACT (REG Co) No 5

CITATION	19&20 VICT c 47
SHORT TITLE	Joint Stock Companies Act 1856
LONG TITLE	An act for the incorporation and registration of joint stock companies, and other associations (excluding banking companies)
RELEVANT SECTION(S)	a) Table B - cl 74 b) Table B - cl 84
SUBJECT MATTER	a) Regulations for management of the company - audit b) Regulations for management of the company - audit
WORDING OF SECTION(S)	a) <i>"The accounts of the company shall be examined and the correctness of the Balance Sheet ascertained by one or more Auditor or Auditors to be elected by the company in General Meeting."</i> b) <i>"The auditors shall make a Report to the Shareholders upon the Balance Sheet and Accounts, and in every such Report, they shall state whether, in their Opinion, the Balance Sheet is a full and fair Balance Sheet, containing the Particulars required by these Regulations and properly drawn up so as to exhibit a true and correct view of the state of the company's affairs, and in case they have called for Explanations or Information from the Directors, whether such Explanations or Information have been given by the Directors, and whether they have been satisfactory; and such Report shall be read, together with the Report of the Directors, at the Ordinary Meeting."</i>
CASE LAW TO RELEVANT SECTION(S)	None

5.2.4 COMPANIES ACT (REG Co) No 9

CITATION	25&26 VICT c 89
SHORT TITLE	Companies Act 1862
LONG TITLE	An act for the incorporation, regulation and winding up of trading companies and other associations (including banking companies)
RELEVANT SECTION(S)	a) Table A - cl 83 b) Table A - cl 94
SUBJECT MATTER	a) Regulations for management of a company limited by shares - Audit b) Regulations for management of a company limited by shares - Audit
WORDING OF SECTION(S)	a) <i>"Once at the least in every year, the Accounts of the Company shall be examined and the correctness of the Balance Sheets ascertained, by One or more Auditor or Auditors."</i> b) <i>"The auditors shall make a report to the members upon the Balance Sheet and Accounts, and in every such Report they shall state whether, in their opinion, the Balance Sheet is a full and fair Balance Sheet, containing the Particulars required by the Regulations and properly drawn up so as to exhibit a true and correct view of the state of the company's affairs, and in case they have called for Explanations or Information from the Directors, whether such Explanations or Information have been given by the Directors, and whether they have been satisfactory; and such report shall be read, together with the Report of the Directors, at the Ordinary Meeting."</i>
CASE LAW TO RELEVANT SECTION(S)	<i>Leeds Estate, Building and Investment Co v Shepherd (1887) 36 ChD 787</i>

5.2.5 COMPANIES ACT (REG Co) No 13

CITATION 42&43 VICT c 76

SHORT TITLE Companies Act 1879

LONG TITLE An act to amend the law with respect to the liability of members of banking and other joint stock companies; and for other purposes

RELEVANT SECTION(S) a) s7(1)

b) s7(6)

SUBJECT MATTER a) Audit of Accounts of Banking companies

b) Audit of Accounts of Banking companies

WORDING OF SECTION(S) a) *"Once at the least in every year, the accounts of every banking company registered after passing of this Act as a limited company shall be examined by an auditor or auditors who shall be elected annually by the company in general meeting."*

b) *"The auditor or auditors shall make a report to the members on the accounts examined by him or them, and on every balance sheet laid before in general meeting during his or their tenure of office; and in every such report shall state whether in his or their opinion, the balance sheet referred to in the report is a full and fair balance sheet properly drawn up so as to exhibit a true and correct view of the state of the company's affairs, as shown by the books; and such report shall be read before the company in general meeting."*

CASE LAW TO *London and General Bank (1895) 2 Ch 673*

RELEVANT SECTION(S)

5.2.6 COMPANIES ACT (REG Co) No 21

CITATION 63&64 VICT c 48

SHORT TITLE Companies Act 1900

LONG TITLE An act to amend the Companies Acts

RELEVANT SECTION(S) a) s21(1)

b) s23

SUBJECT MATTER a) Audit - appointment of auditors

b) Audit - rights and duties of auditors

WORDING OF SECTION(S) a) *"Every company shall at each annual general meeting appoint an auditor or auditors to hold office until the next annual general meeting."*

b) *"Every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, and shall be entitled to require from the directors officers of the company such information and explanation as may be necessary for the performance of the duties of the auditors, and the auditors shall sign a certificate at the foot of the balance sheet stating whether or not all their requirements as auditors have been complied with, and shall make a report to the shareholders on the accounts examined by them, and on every balance sheet laid before the company in general meeting during their tenure of office; and in every such report shall state whether, in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as shown by the books of the company; and such report shall be read before the company in general meeting."*

CASE LAW TO RELEVANT SECTION(S) *Newton v Birmingham Small Arms Company, Limited (1906) 2 Ch 378*

5.2.7 COMPANIES ACT (REG Co) No 22

CITATION 7 EDW 7 c 50

SHORT TITLE Companies Act 1907 and the Companies Acts 1862 to 1900

LONG TITLE An act to amend the Companies Acts 1862 to 1900

RELEVANT SECTION(S) s19(2)

SUBJECT MATTER Auditors (Report)

WORDING OF SECTION(S) *"The auditors shall make a report to the shareholders on the accounts examined by them, and on every balance sheet laid before the company in general meeting during their tenure of office, and the Report shall state -*

a) whether or not they have obtained all the information and explanations they have required; and

b) whether in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs, according to the best of their information and the explanations given to him and as shown by the books of the company."

CASE LAW TO RELEVANT SECTION(S) None

5.2.8 COMPANIES ACT (REG Co) No 23

CITATION 8 EDW 7 c 69

SHORT TITLE Companies (Consolidation) Act 1908

LONG TITLE An act to consolidate the Companies Act 1862 and the Acts amending it

RELEVANT SECTION(S) s113(2)

SUBJECT MATTER Duties of auditors

WORDING OF SECTION(S) *"The auditors shall make a report to the shareholders on the accounts examined by them, and on every balance sheet laid before the company in general meeting during their tenure of office, and the report shall state -*

a) whether or not they have obtained all the information and explanations they have required; and

b) whether in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs, according to the best of their information and the explanations given to them and as shown by the books of the company."

CASE LAW TO RELEVANT SECTION(S) 1) *Cuff v London and County Land and Building Co, Ltd (1912) 1 Ch 440*

2) *Re City Equitable Fire Insurance Co., Ltd (1925) 1 Ch 407*

5.2.9 COMPANIES ACT (REG Co) No 29

CITATION 19&20 GEO c 23

SHORT TITLE Companies Act 1929

LONG TITLE An act to consolidate the Companies Act 1908 to 1928, and certain other enactments connected with the said Acts

RELEVANT SECTION(S) s134(1)

SUBJECT MATTER Auditors' Report

WORDING OF SECTION(S) *"The auditors shall make a report to the shareholders on the accounts examined by them, and on every balance sheet laid before the company in general meeting during their tenure of office, and the report shall state-*

a) whether or not they have obtained all the information and explanations they have required; and

b) whether in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs, according to the best of their information and the explanations given to them and as shown by the books of the company."

CASE LAW TO RELEVANT SECTION(S) None

5.2.10 COMPANIES ACT (REG Co) No 30

CITATION 10&11 GEO 6 c 47

SHORT TITLE Companies Act 1947

LONG TITLE An act to amend the law relating to companies and unit trusts and to dealing in securities, and in connection therewith to amend the law of bankruptcy and the law relating to the registration of business names

RELEVANT SECTION(S) 1) s22(1)

2) Second Schedule

SUBJECT MATTER 1) Extension of duties of auditors

2) Matters to be expressly stated in auditors' report

WORDING OF SECTION(S)

1) *"The duties of a company's auditors as laid down by section one hundred and thirty-four of the principal Act shall be extended as follows:-*

a) *they shall report on every profit and loss account and all group accounts laid before the company in general meeting during their tenure of office (as well as on every balance sheet so laid and on the accounts examined by them); and*

b) *their report shall contain (in lieu of the statements required by subsection(1) of the said section one hundred and thirty-four) statements as to the matters mentioned in the Second Schedule to this Act;*

and section three hundred and sixty-two of the principal Act (which penalises false statements) shall apply to the auditors' report, as if the reference in the Eleventh Schedule to the Act to subsection(1) of the said section one hundred and thirty-four included a reference to this subsection.

2) *Second Schedule*

(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) (i) *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*

(ii) *whether, in their opinion and to the best of their information and according to the explanations given them, the said accounts give the information required by the principal Act and 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 First Schedule to this Act are not required to be disclosed.

- (4)** *In the case of a holding company submitting group accounts whether, in their opinion, the group accounts have been properly prepared in accordance with the provisions of this Act so as to give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries dealt with thereby, so far as concerns members of the company, or as the case may be, so as to 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 First Schedule to this Act are not required to be disclosed. "*

CASE LAW TO None
RELEVANT
SECTION(S)

5.2.11 COMPANIES ACT (REG Co) No 31

CITATION	11&12 GEO 6 c 38
SHORT TITLE	Companies Act 1948
LONG TITLE	An act to consolidate the Companies Act 1929, the Companies Act 1947 (other than the provisions thereof relating to the registration of business names, bankruptcy and the prevention of fraud in connection with unit trusts) and certain other enactments amending the first mentioned Act
RELEVANT SECTION(S)	1) s162(1) 2) Ninth Schedule
SUBJECT MATTER	1) Auditors' Report 2) Matters to be expressly stated in Auditors' report
WORDING OF SECTION(S)	1) <i>"The auditors shall make a report to the members on the accounts examined by them, and on every balance sheet, every profit and loss account and all group accounts laid before the company in general meeting during their tenure of office, and the report shall contain statements as to the matters mentioned in the Ninth Schedule to this Act</i> 2) <i>Ninth Schedule</i> (1) <i>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</i> (2) <i>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.</i>

- (3) (i) *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*
- (ii) *whether, in their opinion and to the best of their information and according to the explanations given them, the said accounts give the information required by the principal Act and 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.

- (4) *In the case of a holding company submitting group accounts whether, in their opinion, the group accounts have been properly prepared in accordance with the provisions of this Act so as to give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries dealt with thereby, so far as concerns members of the company, or as the case may be, so as to 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 Eight Schedule to this Act are not required to be disclosed."*

CASE LAW TO ***Re Thomas Gerrard & Son Ltd (1967) 2 ALL ER 525***
RELEVANT
SECTION(S)

5.2.12 COMPANIES ACT (REG Co) No 33

CITATION 15&16 ELIZ 2 c 81

SHORT TITLE Companies Act 1967

LONG TITLE An act to amend the law relating to companies, insurance partnerships and moneylenders

RELEVANT SECTION(S) s14(1), (3), (4), (6)

SUBJECT MATTER Auditors' Report

WORDING OF SECTION(S) s14(1) -
"The auditors of a company shall make a report to the members on the accounts examined by them, and on every balance sheet, every profit and loss account and all group accounts laid before the company in general meeting during their tenure of office."

s14(3) -
"The report shall -

(a) except in the case of a company that is entitled to avail itself, and has availed itself, of the benefits of any of the provisions of Part III of Schedule 8 to the principal Act, state whether in the auditors' opinion the company's balance sheet and profit and loss account and (if it is a holding company submitting group accounts) the group accounts have been properly prepared in accordance with the provisions of the principal Act and this Act and whether in their opinion a true and fair view is given -

- (i) in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year;*
 - (ii) in the case of the profit and loss account (if it be not framed as a consolidated profit and loss account), of the company's profit or loss for its financial year;*
 - (iii) in the case of group accounts submitted by a holding company, of the state of affairs and profit or loss of the company and its subsidiaries dealt with thereby, so far as concerns members of the company*
- (b) in the said excepted case, state whether in the auditors' opinion the company's balance sheet and profit and loss account and (if it is a holding submitting group accounts) the group accounts have been properly prepared in accordance with the provisions of the principal Act and this Act."*

s14(4) -

"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;*

and if the auditors are of opinion that proper books of account have not been kept by the company or that proper returns adequate for their audit have not been received from branches not visited by them, or if the balance sheet and (unless it is framed as a consolidated profit and loss

account) profit and loss account are not in agreement with the books of account and returns, the auditors shall state that fact in their report."

s14(6) -

"If the auditors fail to obtain all the information and explanations which to the best of their knowledge and belief, are necessary for the purposes of their audit, they shall state that fact in their report."

CASE LAW TO **None**
RELEVANT
SECTION(S)

5.2.13 COMPANIES ACT (REG Co) No 37

CITATION 29&30 ELIZ 2 c 62

SHORT TITLE Companies Act 1981

LONG TITLE An act to amend the law relating to companies and business names

RELEVANT SECTION(S) s15

SUBJECT MATTER Auditors to check consistency of directors' report with accounts

WORDING OF SECTION(S) The following section shall be inserted after section 23 of the 1967 Act-

"23A -

(1) *it shall be the duty of the auditors of the company, in preparing their report under section 14 of this Act on the company's accounts, to consider whether the information given in the directors' report relating to the financial year in question is consistent with those accounts*

(2) *If the auditors are of opinion that the information given in the directors' report is not consistent with the company's accounts for the financial year, they shall state that fact in their report under section 14.*"

CASE LAW TO RELEVANT SECTION(S) None

5.2.14 COMPANIES ACT (REG Co) No 39

CITATION 33&34 ELIZ 2 c 6

SHORT TITLE Companies Act 1985

LONG TITLE An act to consolidate the greater part of the Companies Acts

RELEVANT 1) s236

SECTION(S)

2) s237(1), (2), (4), (5), (6)

SUBJECT 1) Auditors' Report

MATTER

2) Auditors' Duties

WORDING OF 1) s236 -

SECTION(S)

(1) *"A company's auditors shall make a report to its members on the accounts examined by them, and on every balance sheet, and profit and loss account, and on all group accounts, copies of which are to be laid before the company in general meeting during the auditors' tenure of office,*

(2) *The auditors' report shall state -*

(a) *whether in the auditors' opinion the balance sheet and profit and loss account and (if it is a holding company submitting group accounts) the group accounts have been properly prepared in accordance with this Act; and*

(b) *without prejudice to the foregoing, whether in their opinion, a true and fair view is given -*

(i) *in the balance sheet, of the state of the company's affairs at the end of the financial year;*

(ii) in the profit and loss account (if not framed as a consolidated account), of the company's profit or loss for the financial year; and

(iii) in the case of group accounts of the state of affairs and profit or loss of the company and its subsidiaries dealt with by those accounts, so far as concerns members of the company."

2) s237 -

(1) "It is the duty of the company's auditors in preparing their report, to carry out such investigations as will enable them to form an opinion as to the following matters -

(a) whether proper accounting records have been kept by the company and proper returns adequate for their audit have been received from branches not visited by them,

(b) whether the company's balance sheet and (if not consolidated) its profit and loss account are in agreement with the accounting records and returns.

(2) If the auditors are of opinion that proper accounting records have not been kept, or that proper returns adequate for their audit have not been received from branches not visited by them, or if the balance sheet and (if not consolidated) the profit and loss account are not in agreement with the accounting records and returns, the auditors shall state that fact in their report.

(4) If the auditors fail to obtain all the information and explanations which to the best of their knowledge and belief, are necessary for the purposes of their audit, they shall state that fact in their report.

(5) If the requirements of Parts V and VI of Schedule 5 and Parts I to III of Schedule 6 are not complied with in the accounts, it is the auditors' duty to include in their report, so far as they are reasonably able to do so, a statement giving the required particulars.

(6) It is the auditors' duty to consider whether the information given in the directors' report for the financial year for which the accounts are prepared is consistent with those accounts, and if they are of opinion that it is not, they shall state that fact in their report."

CASE LAW TO **Caparo Industries plc v Dickman and Others (1990) 1 ALL ER 568**
RELEVANT
SECTION(S)

5.2.15 COMPANIES ACT (REG Co) No 41

CITATION 36&37 ELIZ 2 c 40

SHORT TITLE Companies Act 1989

LONG TITLE An act to amend the law relating to company accounts; to make new provision with respect to the persons eligible for appointment as company auditors; to amend the Companies Act 1985 and certain other enactments with respect to investigations and powers to obtain information and to confer new powers exercisable to assist overseas regulatory authorities; to make new provision with respect to the registration of company charges and otherwise to amend the law relating to companies; to amend the Fair Trading Act 1973; to enable provision to be made for the payment of fees in connection with the exercise by the Secretary of State, the Director General of Fair Trading and the Monopolies and Mergers Commission of their functions under Part V of that Act; to make provision for safeguarding the operation of certain financial markets, to amend the Financial Services Act 1986; to enable provision to be made for the recording and transfer of title to securities without a written instrument; to amend the Company Directors Disqualification Act 1986, the Company Securities (Insider Dealing) Act 1985, the Policy Protection Act 1975 and the law relating to building societies and for connected purposes.

RELEVANT SECTION(S) s9

SUBJECT MATTER Auditors' Report

WORDING OF SECTION(S) The following sections are inserted in Part VII of the Companies Act 1985 -

s235(2) -

"The auditor's report shall state whether in the auditor's opinion the annual accounts have been properly prepared in accordance with this Act, and in particular whether a true and fair view is given -

- (a) in the case of an individual balance sheet, of the state of affairs of the company as at the end of the financial year,**
- (b) in the case of an individual profit and loss account, of the profit or loss of the company for the financial year,**
- (c) in the case of group accounts, of the state of affairs as at the end of the financial year, and the profit or loss for the financial year, of the undertakings included in the consolidation as a whole, so far as concerns members of the company."**

s235(3) -

"The auditors shall consider whether the information given in the directors' report for the financial year for which the annual accounts are prepared is consistent with those accounts, and if they are of opinion that is not, they shall state that fact in their report."

s237(1) -

"A company's auditors shall, in preparing their report, carry out such investigations as will enable them to form an opinion as to -

- (a) whether proper accounting records 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 individual accounts are in agreement with the accounting records and returns."**

s237(2) -

"If the auditors are of opinion that proper accounting records have not been kept, or that proper returns adequate for their audit have not been

received from branches not visited by them, or if the company's individual accounts are not in agreement with the accounting records and returns, the auditors shall state that fact in their report. "

s237(3) -

"If the auditors fail to obtain all the information and explanations which to the best of their knowledge and belief, are necessary for the purposes of their audit, they shall state that fact in their report. "

s237(4) -

"If the requirements of Schedule 6 (disclosure of information: emoluments and other benefits of directors and others) are not complied with in the annual accounts, the auditors' shall include in their report, so far as they are reasonably able to do so, a statement giving the required particulars. "

CASE LAW TO
RELEVANT
SECTION(S)

None

5.3 ENVOI

This chapter has sought to apply the capture stage of EISI in the process of data collection. All in all, 15 Companies Acts were situated from the 41 Companies Acts located during the period 1844-1989.

The capture stage has been addressing the first framed H_1 question of 'When and where did these statutory duties emerge?' Now that these duties have been ascertained, it is now necessary to move on to the next phase of EISI, bracketing, where the next framed question is addressed on 'What were the extent of those statutory duties in the context of fraud detection?' This leads us to the next chapter: the mini stage.

CHAPTER 6

THE MINI STAGE

6.0 PRELUDE

"Once upon a time, there was a man who travelled far in search of a widely proclaimed food called 'fruit'.. When finally directed to a fruit tree, he confused the spring blossom of the tree with the fruit of the tree. Finding the blossom to be tasteless, he dismissed all he had heard about fruit as a hoax - and went on his way.

While the first seeker after fruit arrived too early to experience the ripened delicacy, and tasted only the blossom, a second seeker after fruit arrived at a tree that had been improperly cultivated, so that its fruit was shrivelled and bitter. This fruit had been left to rot. Not knowing what good fruit looked like, he sampled the bad. 'Well, I've seen and tasted fruit', he said, 'and I can tell you for sure that it's terrible. I've had it with fruit. Forget it. That stuff is awful.' He went on his way and his journey was wasted.

A third seeker after fruit arrived at the same tree which produced the shrivelled and bitter fruit. He picked some of the rotting fruit and examined it. He took the fruit to a farmer who cultivated fruit trees with great success. The farmer peeled away the rotten exterior and exposed the stone inside. The farmer told him how to plant the stone, cultivate the resulting tree, and harvest the desired delicacy. The farmer also gave him a plump, ripe sample to taste. Once the seeker after fruit knew what fruit really was, and once he knew that the stone he held in his hand was a seed, all he had to do was to plant and tend properly the tree's growth and work for the eventual harvest - the fruit. Though there was much work to be done and many things to be learned, the resulting high quality fruit was worth the effort."

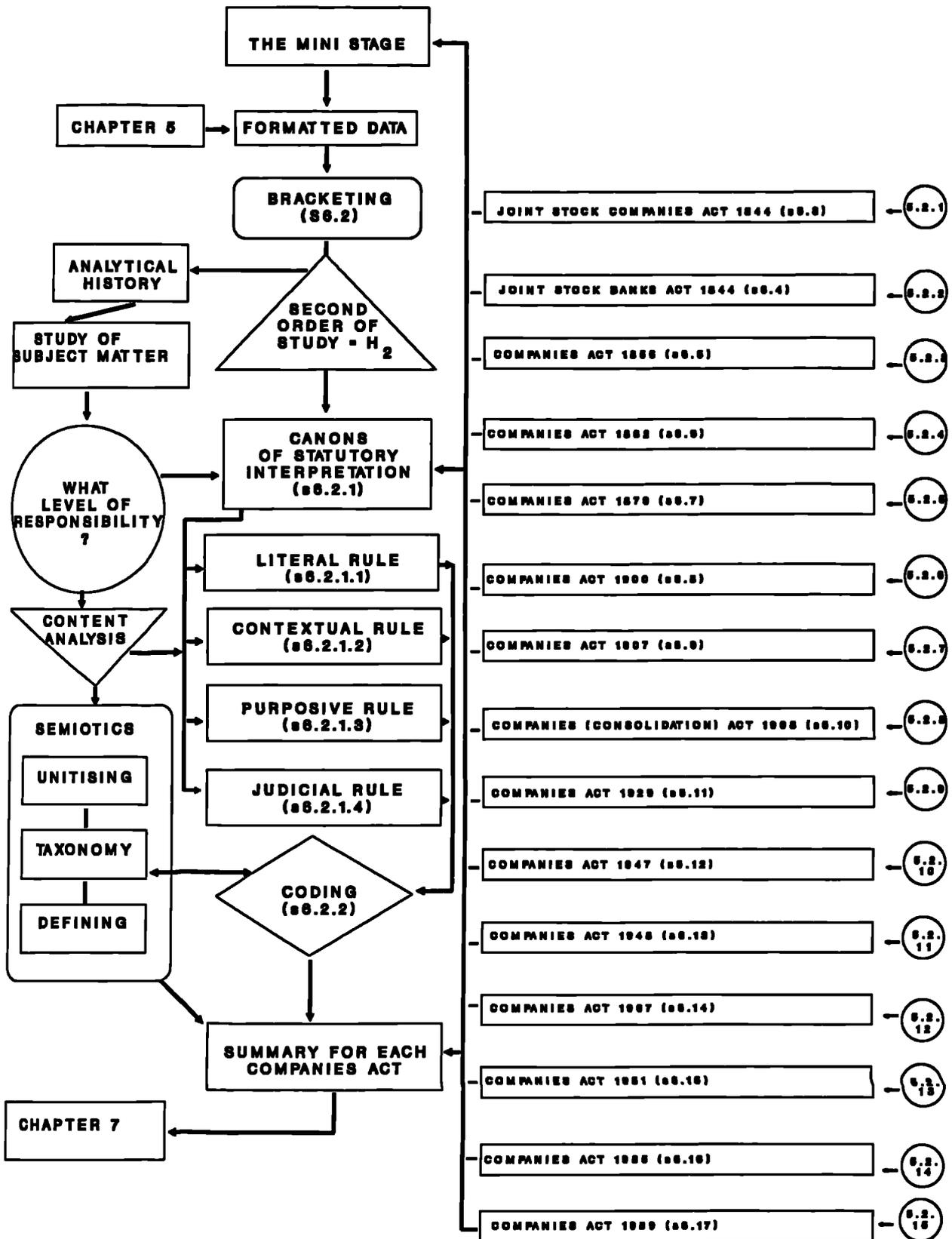
Adapted from Patton (1980), p37

6.1 INTRODUCTION

This chapter seeks to carry out the bracketing stage of EISI as explained in Chapter 4. As shown in Figure 6'1, this second order of study analyses and studies the raw empirical data by asking the question: what is the level or extent of the auditor's statutory responsibility towards fraud detection? It will involve a branch of content analysis called semiotics which will involve highlighting key texts, words or phrases into units (unitising), providing a coding system (taxonomy) and using it to define the statutory texts.

Preconceptions are suspended and put aside during bracketing. The statutory text is confronted as much as possible on its own terms under the canons of interpretation.

Figure 6.1 : FRAMEWORK OF CHAPTER 6



This chapter begins by making explicit the four canons of statutory interpretation adopted for this study, namely literal, contextual, purposive and judicial. A system of coding is then devised to classify all these multiple 'fruits' of mini interpretations that embody the phenomenon in question. Each of the 15 formatted Companies Acts are then systematically brought under the microscope of the four canons, coded accordingly and summarised.

By doing so, it will provide the groundwork for locating the epiphanies or turning points and for the interpretations emerging in the next chapter.

6.2 BRACKETING

As mentioned in Chapter 4, bracketing involves locating key texts that speak of the phenomenon to uncover and interpret its essential definitional meanings for further analysis and interpretation. But before doing so, it is necessary to make explicit the set of rules employed to decipher such bracketed texts. Such set of rules are referred to in this study as the canons of statutory interpretation.

6.2.1 THE CANONS OF STATUTORY INTERPRETATION

Ever since R M Dworkin published a seminal article titled *Model of Rules* in 1967, it has become fashionable to divide the contents of a legal system into rules and principles. One of the examples of a rule given by him is that the maximum legal speed on the turnpike is 60 miles per hour.

"Rules are applicable in an all-or-nothing fashion. If the facts a rule stipulates are given, then either the rule is valid, in which case the answer it supplies must be accepted, or it is not, in which case it contributes nothing to the decision."

(Dworkin 1981, p24)

One of Dworkin's examples of a principle is no man may profit from his own wrong. This is recognised by English law and has formed the basis of a number of decisions, but judges are not obliged to apply it in the sense in which they are obliged to apply a rule after making certain findings of fact. The law sometimes permits a man to profit from his own wrong as when it protects the adverse possessor of property even against the owner. Once a principle has been applied in a case, it frequently creates a rule to which effect must be given in similar situations in the future. A principle may

rationalise a number of specific legal rules or set out a goal of the law in a generalised way, but there is no requirement that a principle be applied in the same way or to the same extent in relation to different statutes.

"All that is meant, when we say that a particular principle is a principle of our law, is that the principle is one which officials must take into account, if it is relevant, as a consideration inclining in one direction or another."

(Dworkin 1981, p26)

Principles, unlike rules, may conflict without detriment to the operation of the legal system as a whole, and, again unlike rules, they may vary in the degree of their persuasiveness. Of course rules can and do have exceptions, but if two rules are contradictory of each other, there is something seriously wrong with the law. It has yet to be suggested that there is something seriously wrong with the canons of statutory interpretation because of the frequent conflict between the principles that statutes should be construed so as to alter the common law as little as possible, and that they should be construed so as to conform to international law.

If one applies Dworkin's terminology to the canons of statutory interpretation, there are two sets of rules, one so general as to approximate to a principle, and the other subject to an ill-defined limitation. For the rest, there is a congeries of principles capable of pointing in different directions and incapable of arrangement in any kind of systematic hierarchy according to their differing degrees of persuasiveness. This paucity of rules and confusion of principles amply justifies Lord Wilberforce's description of statutory interpretation in the House of Lords Debates (Session 16 November 1966 col 1294) as *"what is nowadays popularly called a non-subject"*. He has since amplified this remark by stating:

"I still think that the interpretation of legislation is just part of the process of being a good lawyer; a multi-faceted thing, calling for many varied talents; not a subject which can be confined in rules."

(House of Lords Debates, Session 9 March 1981 col 73)

Lord Wilberforce was expressing doubts about the subject's suitability for law reform, but the matters which have just been mentioned also render it extremely difficult to give a coherent account of the subject or to assess the merits of criticisms.

The following three passages from speeches of Lord Reid in the House of Lords' cases may be cited in support of the remarks made at the last paragraph:

- (i) ***"In determining the meaning of any word or phrase in a statute, the first question to ask always is what is the natural or ordinary (literal) meaning of that word or phrase in its context in the statute? It is only when that meaning leads to some result which cannot reasonably be supposed to have been the intention of the legislature that it is proper to look for some other possible meaning of the word or phrase." [Pinner v Everett (1969) 3 ALL ER 257 at 258-9]***

- (ii) ***"Then (in case of doubt) rules of construction are relied on. They are not rules in the ordinary sense of having some binding force. They are our servants, not our masters. They are aids to construction, presumptions or pointers. Not infrequently one 'rule' points in one direction, another in a different direction. In each case we must look at all relevant circumstances and decide as a matter of judgement what weight to attach to any particular 'rule'." [Maunsell v Olins (1975) AC 373 at 382]***

- (iii) ***"It is a cardinal principle applicable to all kinds of statutes that you may not for any reason attach to a statutory provision a meaning which the words of that provision cannot reasonably bear. If they are capable of more than one meaning, then you can choose between those meanings, but beyond that you must not go." [Jones v Director of Public Prosecutions (1962) AC 635 at 662]***

The first quotation provides some modes for approaching statutory interpretation, namely literal, contextual and others such as purposive in contrast with judicial. These modes will be expanded in the next section.

The inverted commas round the word 'rule' in the second quotation show that Lord Reid was fully aware of the distinction between rules and principles taken by Dworkin, but consistency with the terminology used by the latter requires the substitution of 'principle' for 'rule' in that quotation.

The second quotation comes from a case in which he entertained doubts about the meaning of the word 'premises' in s18(5) of the Rent Act 1968. Was the word in the particular context limited to premises which were dwelling houses? There was a wide choice of meanings and no question of avoiding an absurdity produced by the application of the literal meaning. Accordingly, when answering the question raised in

the affirmative, Lord Reid considered it was right to review the legislative history of the provision and to lean in favour of the construction involving the least interference with the common law.

The third of the numbered quotations from Lord Reid's speeches refers to a 'rule' rather than a 'principle' in the sense in which those terms are used by Dworkin. It is an absolute prohibition on going beyond certain limits; the words must not be given a meaning they cannot, by any stretch of imagination, bear. This point was neatly put by Eyre C B in a case concerned with the construction of private documents.

"All latitude of construction must submit to this restriction: namely that the words may bear the sense which by construction is put upon them. If we step beyond this line, we no longer construe men's deeds, but make deeds for them."

[Gibson and Johnson v Minet and Fector (1791) H BL 569 at 615]

The restriction marks the boundary between interpretation and alteration.

The statutory 'rules' of interpretation are now explained under the following sub-headings: the literal rule, contextual rule, purposive rule and judicial rule.

6.2.1.1 THE LITERAL RULE

Under this mode of interpretation, the words used in the statutes are given their plain, ordinary or literal meaning. The question asked is: what is the meaning of these statutory words when read alone? The objective here is to discover the intention of Parliament as only expressed in the words used themselves [per Viscount Dilhorne in *Stock v Frank Jones (Tipton Ltd) (1978) 1 ALL ER 948 at 951*]

Lord Diplock in *Duport Steels Ltd v Sirs (1980) 1 ALL ER 529 at 541* said:

"When Parliament legislates to remedy what the majority of its members at the time perceive to be a defect or a lacuna in the existing law (whether it be the written law enacted by existing statutes or the unwritten common law as it has been expanded by the judges in decided cases), the role of the judiciary is confined to ascertaining from the words that Parliament has approved as expressing its intention what the intention was, and to giving effect to it. Where the meaning of the statutory words is plain and unambiguous, it is not for the judges to invent fancied ambiguities as an excuse for failing to give effect to its plain meaning."

If the words used are quite clear, they must be applied in their plain meaning even though the result is absurd, or even when one may dislike the statute, or even though the literal interpretation may inflict hardship on those affected by the legislation.

Lord Edmund-Davies in the *Stock v Frank Jones (Tipton Ltd)* case above said:

"Dislike of the effect of a statute has never been an accepted reason for departing from its plain language. Holt C J said nearly three centuries ago: 'An Act of Parliament can do no wrong, though it may do several things that look pretty odd'".

Thus in *Leedale v Lewis (1982) 3 ALL ER 808*, the unanimous opinion of the House of Lords was that if the meaning of a taxation statute is clear, it must be given effect to and the Court should not seek to discover some alternative interpretation namely because the true literal meaning involves hardship for the taxpayer.

Similarly, a person is not homeless for the purposes of the Housing (Homeless Persons) Act 1977 (now part III of the Housing Act 1985) if he is occupying 'accommodation' within the literal meaning of that word, even though the place which he occupies is unfit for habitation (lacking in cooking and washing facilities and he is thereby compelled to eat out and to use a launderette for washing his clothes [*Puhlhofer v Hillingdon London Borough Council (1986) 1 ALL ER 467*]). It might be otherwise where the 'accommodation' is not, by reason of its size, capable of accommodating a person together with others who normally reside with him as members of his family (*ibid*, at p474 per Lord Brightman). Such a place could not be described as 'accommodation' in any meaningful, relevant and literal sense.

It should also be appreciated in relation to the literal rule of interpretation that the ordinary meaning of a technical word is something technical. In *Unwin v Hanson (1891) 2 QB 115*, the Highways Act 1835 empowered the borough surveyor to prune and lop trees which excluded light from the highway. The plaintiff sued a borough surveyor who had cut the tops off the plaintiff's trees. It was shown in evidence that in forest terminology 'prune' meant removing surplus branches to improve growth and 'lop' meant to cut branches from the side of the tree. The defendant had done neither of these things. He had 'topped' the trees when he had no power to do so in the technical sense.

In *Munby v Furlong* (1977) 2 All ER 953, the Court of Appeal held that the word 'plant' in a taxation statute covered books bought by a barrister for the purpose of his practice and that, therefore, he was entitled to an allowance for capital expenditure. Lord Denning M R said (at p956) that the word 'plant' in a taxation statute did not mean what the ordinary Englishman thought it meant. It had acquired a special technical meaning in tax cases. It was not limited to things used physically, like machinery, but covered the 'intellectual storehouse' which a professional man has in exercising his profession.

Unless it can be shown that the statutory framework or the legal context in which the words are used requires a different meaning, the words of the statute should be assigned their literal and ordinary meaning. This approach [in the words of Lord Scarman] in *Shah v Barnet London Borough Council* (1983) 1 ALL ER 226 at 237:

"helps to prevent the growth and multiplication of refined and subtle distinctions in the law's use of common English words. Nothing is more confusing and more likely to bring the statute law into disrepute than a proliferation by judicial interpretation of special meanings, when Parliament has not expressly enacted any."

In order to arrive at the proper literal meaning of the words used in a statute a judge may have recourse to ordinary standard English dictionaries for the common speech meanings [as in *R v Inner London Education Authority ex parte Westminster City Council* (1986) 1 ALL ER 19 at 32, where a Shorter Oxford Dictionary definition was applied to the word 'information' in the Local Government Act 1972]. Bennion (1990) noted that most judges allow their putative memories to be refreshed by the citation of dictionaries. Lord Coleridge said of dictionaries:

"it is a well-known rule of Courts of law that words should be taken to be used in their ordinary (literal) sense, and we are therefore sent for instruction to these books"
[R v Peters (1886) 16 QBD 636 at 641]

A dictionary cited should be 'well known and authoritative' [*Camden(Marquess) v IRC* (1914) 1 KB 641, per Cozen-Hardy M R at 648].

Other points of literal reference are to the Definition Section (if any) in the Act, to the Interpretation Acts of 1850, 1889 and 1978 which Willis (1938) refers to as its statutory dictionary. The Interpretation Acts do provide definitions for various words

and expressions. These definitions are to be used in construing any Acts which contain those words or expressions (Interpretation Act 1978 s5 and Schedule 1).

If these various aids to construction are of little assistance to the judge in a particular case, then he must simply decide for himself what the words mean. The case of *Mandla v Dowell Lee (1983) 1 ALL ER 1062* (the 'Sikh turban case') turned on the meaning of the word ethnic in s3 of the Race Relations Act 1976. The word is not defined in the Act itself and recourse was had, in both the Court of Appeal and the House of Lords, to dictionary definitions. But all of them were rejected by the House of Lords, which eventually held (based on their personal literal interpretation which reversed the Court of Appeal's decision) that Sikhs are a racial, and not solely a religious group for the purposes of the race relations legislation (per Lord Fraser of Tullybelton at p1066).

In conclusion, the above provided some insight into the various tools used by the Courts in adopting the literal rule. The tools are then applied into the mini literal stages later on. Thus, in arriving at the natural, ordinary literal meaning of the words used in the subsequent Companies Acts defining the statutory duties of the auditors, the following steps are observed.

Firstly, one looks to see if the words are defined within the Act itself by reference to the Interpretation or Definition Section of the Act. Next, the Interpretation Acts of 1850, 1889 and 1978 are turned to for assistance. Failing that, recourse is made to dictionaries, in particular the Shorter Oxford Dictionary. An indication of the period for the first date of the occurrence of the word is given preceding the definition to confirm that the word was in contemporary use at the time that Act was passed. The date of the introduction of a word and that its meaning is still being used is very relevant to its construction simply because the meaning of a word may change with the passage of time and the 'material' time is generally said to be that at which the word is used. And if none of the above three aids are of any assistance, then one would have to decide for oneself what the words could possibly mean in the light of company law legislation.

6.2.1.2 THE CONTEXTUAL RULE

One of the implicit rules for the interpretation of statutes is that suggested by common sense. One may look up the meaning of a word in a dictionary, but this literal meaning

may be dictated by the particular context. Here the question asked is: what is the meaning of these statutory words when read together with the rest of the words of the Act?

As stated by Williams (1982): "One who has translated from a foreign language knows that it is no excuse for a bad translation even though the meaning chosen was validly found in the dictionary; for the document (eg Companies Acts) may be its own dictionary, showing an intention to use words in some special shade of meaning" (p98).

This rule, taking the context into consideration, is sometimes expressed in the Latin maxim *NOSCITUR A SOCIIS*: a word may be known by the company it keeps. The words used in a statute can be interpreted out of their context. Each section in a statute must be read subject to every other section, which may explain or modify it.

One may look not only at the rest of the section in which the word appears but at the statute as a whole, and even at earlier legislation dealing with the same subject-matter. For it is assumed that when Parliament passed an Act, it probably had the earlier legislation in mind, and probably intended to use words with the same meaning as before. Somewhat anomalously, Williams (1982) asserted that reference may even be made to later statutes, to see the meaning that Parliament puts on the same words in a similar context. But, words may not always have the same meaning given to them: the same word can bear two different meanings when it is used in the same section, as in the case of *West Midlands Joint Electricity Authority v Pitt (1932) 2 KB 1 at 46* where the word 'terms' was illustrated as having a pecuniary and non-pecuniary sense.

Williams (1982) added that: "Formerly, recourse to earlier statutes was taken to allow the Court to compare the wording of a consolidation Act with the Acts that it superseded, and to conclude that variation of wording indicated a change of meaning. But this tended to defeat the object of consolidation, which was to supersede a jumble of Acts of various dates by a single statute. Consolidation would be of little help if one still had to look at the old repealed Acts in order to interpret the new one.

Consequently, the rule laid down by the House of Lords case is that where in construing a consolidation Act,

"the actual words are clear and unambiguous in their meaning, it is not permissible to have recourse to the corresponding provisions in the earlier statute repealed by the consolidation Act and to treat any difference in their wording as capable of casting doubt upon what is clear and unambiguous language in the consolidating Act itself."

***[per Lord Diplock in Metropolitan Police Comrs v Curran (1976) 1 ALL ER 162 at 165]ⁿ
(p98-99)***

One particular application of this contextual rule is EXPRESSIO UNIUS EST EXCLUSIO ALTERIUS: the express mention of a person or thing excludes by implication other persons or things not mentioned. In *Tempest v Kilner (1846) 3 CB 249*, it was held that the Statute of Frauds 1677, s17 (now repealed), which required a contract for the sale of 'goods, wares and merchandise' for £10 or more to be evidenced in writing, did not apply to a contract for the sale of stocks and shares. The latter were not 'goods, wares and merchandise' and were excluded by implication because they received no express mention.

Another particular, and more common application is the so-called EJUSDEM GENERIS: of the same kind rule. This provides that general words which follow particular words must be limited to meanings similar to those of the particular words. In *Wood v Commissioner of Police for the Metropolis (1986) 2 ALL ER 570*, it was held that a piece of glass accidentally broken was not an offensive weapon within the meaning of the words 'any gun, pistol, hanger, cutlass, bludgeon, or other offensive weapon' in s4 of the Vagrancy Act 1824. The general words 'other offensive weapon' had to be construed ejusdem generis with the preceding words, which comprised a list of articles made or adapted for the purpose of causing injury.

The tools mentioned above provided some guidelines into the application of the mini contextual stage later on. One would carry out a scan of the other parts of the statute to obtain some contextual understanding of the relevant section, which may further explain or modify it.

6.2.1.3 THE PURPOSIVE RULE

Lord Blackburn made a remarkable point on statutory interpretation in *River Wear Comrs v Adamson (1877) 2 AC 743 at 763* when he said:

"In all cases the object is to see what is the intention expressed by the (statutory) words used. But, from the imperfection of language, it is impossible to know what that intention is without inquiring further, and seeing what the circumstances were with

reference to which the words were used, and what was the object, appearing from those circumstances, which the person using them had in view..."

Words and phrases of the English Language have a wide range of meanings. This has been a rich resource in English poetry which makes fruitful use of the resonances, overtones and ambiguities, but it has a concomitant disadvantage in English statute law which seeks unambiguous precision, with the aim that every citizen shall know, as exactly as possible, where he stands under the law.

The first way, says Lord Blackburn, of eliminating legally irrelevant meanings is to look to the statutory objective, ie the purposive construction or interpretation of a statute. Such an approach is considered because of the 'imperfection' or inadequacy of statutory language to express succinctly and clearly the intention of Parliament.

What the purposive approach seeks to show is that Parliament has used words which are capable of meaning either *A* or *B*; although *A* may be the primary literal and ordinary meaning of the words, the purpose of the statutory provision shows that the secondary sense, *B* should be given to the words. In other words, it will be equally right and proper simply to say that such and such a meaning is the literal one in the context but to refer to the purpose as the reason for the conclusion. The question to ask here is: what is the meaning of these statutory words when read against the background of the actual intention of Parliament with which the Act was drafted?

As Bennion (1984) points out, the unit of enquiry in statutory interpretation is an enactment whose legal meaning in relation to a particular factual situation falls to be determined. The text of the relevant enactment may be determined by looking at a single Act of Parliament or even a single provision within it, or by combining elements from several Acts. Having thus established the wording of the statutory text, one can then proceed to determine its meaning in the light of the principles of interpretation or construction.

Seen in this light, statutory interpretation involves determining the meaning of a text contained in one or more documents. Yet judges and writers frequently talk about interpreting the 'will of the legislator' or giving effect to the 'intention of Parliament'. Indeed judges are often criticised for being tied too closely to the statutory words and for failing to give effect to the intentions of Parliament. Such language may appear to suggest that there are two units of enquiry in statutory interpretation - the statutory

text and the intention of Parliament - and that the enquirer must seek to harmonise the two. However, this appearance is deceptive. English law takes the view that the two are closely connected, but in practice primacy is normally given to the text in which the intention of Parliament has been expressed. As Lord Scarman stated:

"If Parliament...says one thing but means another, it is not, under the historic principles of the common law, for the Courts to correct it. That general principle must surely be acceptable in our society."

(House of Lords, Session 9 March 1981 col 65)

The criticism that judges are too tied to the wording of the statutory text is thus not a suggestion that the judges are looking at the wrong subject-matter when interpreting statutes. Rather, the criticism merely suggests that the judges are adopting too narrow a view of the context in which the statutory text is to be read.

Words are normally taken to be understood as having regard to the subject-matter of the legislation. But perhaps, the most effectual way of discovering the true meaning of a law, when the words are dubious, is by considering the reason and spirit of it or the cause which moved the legislator to enact it in the first place.

In *Corkery v Carpenter (1957) 1 KB 102*, a man was arrested without a warrant for being drunk in charge of a bicycle on the highway. By the Licensing Act 1872 s12, a person found drunk in charge of a 'carriage' on the highway may be arrested without a warrant. The Divisional Court held that a bicycle was a 'carriage' for the purposes of the 1872 Act and so the defendant had been properly arrested. The purpose aimed at by the Act was drunken persons on the highway in charge of some form of transport. If the Court had applied the literal rule instead of the purposive rule, the result might well have been different since it is arguable that a bicycle is not a 'carriage' within the ordinary meaning of that word.

All these precepts are typical rules of language applicable to understanding any text, whether legal or not. As with literature, the role of the enquirer is to seek the intention of the legislative author from what is written in the text, and not to seek to construct a text on the basis of the subjective intentions of the author, assuming that they could be discovered.

The sources of historical reference for ascertaining the purpose or intention of Parliament lies in:

- (a) pre-Parliamentary materials relating to the provision or the statute in which it is contained, eg reports of committees and commissions reviewing the existing law and recommending changes, and**
- (b) Parliamentary materials, ie the text of a Bill as first published and successively amended in the passage through Parliament explanatory memoranda, proceedings in committees and Parliamentary Debates (Hansard) in the House of Commons and the Lords.**

The above paragraphs have sought to explain the purposive approach in statutory interpretation. For the application of this mini purposive approach in the subsequent sections, one is trying to ascertain the *raison d'etre* of Parliament in enacting the statutory audit provisions, with fraud detection in particular.

6.2.1.4 THE JUDICIAL RULE

In the English legal system, the law-making process is shared, not necessarily equally, by two bodies. While Parliament claims to be the sole domestic law-maker, its powers are supplemented by the activities of the judiciary, which traditionally has adopted a much less overt role.

The interrelationship between legislation and the judiciary is of crucial importance, for the judges are the ultimate enforcers of the law. Ingman's review in 1987 of the Law Reports indicated that a judge spends about half of his judicial time at the interpretation of legislation. The question to refer here is: what is the meaning that the judge has allocated to these statutory words?

Once a statute is in force, it must be applied by the Courts. The judges have 'judicial notice' of all public Acts whenever passed (s3, Interpretation Act 1978) and of all private Acts passed after 1850 [s22(1) and Schedule 2, para 2, Interpretation Act 1978]. If a judge made a decision without reference to a relevant statute, either because he was ignorant of it or it was not cited to him by counsel, that in itself would provide a ground for appealing.

If a statutory provision is ambiguous or indeterminate, the judge must interpret it before he can apply it. Judicial interpretation of statutes is by no means a precise art. And in looking at the judicial rule, one is trying to obtain a deeper understanding of the role of statutory interpretation in the judicial process.

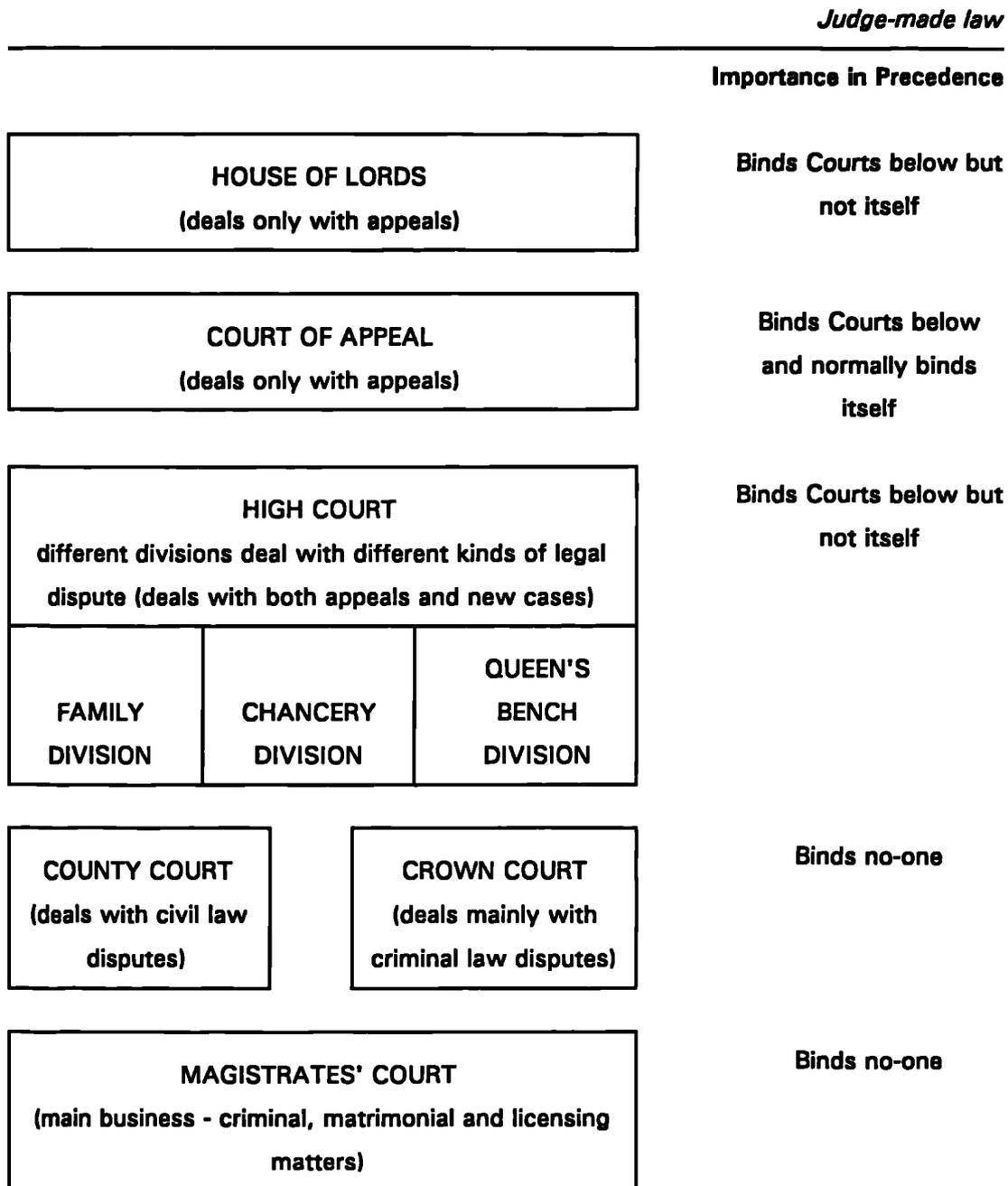
Despite its subservient position, however, there is still scope for judicial interpretation and law-making in the English legal system. When a judge interprets an established rule in relation to a statutory provision to new facts or interprets that the rule does not apply in a certain situation, he is making or changing the law. Of course, he does not have the same freedom as the legislature and must not be seen to be usurping its powers. All judge-made interpretations are inferior to, and can be overruled by Parliamentary or delegated legislation. But unless and until they are overruled, judicial decisions on the interpretation of legislation are precedents just as much as decisions on non-statutory points of law. As such they are subject to the same rule of STARE DECISIS: to stand by cases already decided. Most of English law derives from statute and common law. The function of the judges is to interpret the one and evolve the other.

The doctrine of judicial precedent is one which in English law involves an application of the principle of stare decisis. In practice, this element of compulsion means (as shown in Figure 6·2) that the Court of Appeal is generally bound to follow its own previous decisions and that each Court is bound to follow the decisions of a Court above it in the following hierarchy starting from the House of Lords, Court of Appeal, High Court (Family, Chancery, Queen's Bench), County/Crown Court and Magistrate's Court. It should also be appreciated that the limitations placed on the Courts by the principle of stare decisis are self-imposed.

The judgement or decision of a judge may fall into two parts: the 'ratio decidendi' and 'obiter dictum'. Prior to that, the counsel from either parties (plaintiff and defendant) are allowed to put forward their arguments, including their interpretation of the relevant statutory provisions or the duties of the auditor.

After such hearing, the judge applies the law and arrives at a decision, for which he gives the reason: RATIO DECIDENDI. More precisely, the ratio decidendi of a case is the principle of law on which the decision is based.

Figure 6.2 : HIERARCHY OF COURTS IN THE UK [extracted from Bradney et al (1991) p9]



For the purposes of this research, one is not concerned primarily with the outcome of a case but with the interpretations of the statutory audit provisions in the context of fraud detection which the counsel argued for and the judge gave for the conclusion. The latter's interpretation is important because within it will be found the ratio decidendi. The ratio is that part of the legal interpretation and reasoning which is essential for the decision in the case. It is the ratio which is binding under the doctrine of precedent and which is thus part of the law. The ratio and the reasons for the decision are not necessarily the same thing. Not all the reasons given for the decision will be essential. In Courts where there is more than one judge, each may give a separate judgement. If they do, each judgement will have its own reasons, and thus its own ratio. The judges must agree on a conclusion to the case, although they may do so only by majority. However, they do not have to have the same reasons for their decision or interpretation.

Finding the ratio in a case is crucial. It is also the most difficult part of reading cases, particularly when the case involves several judgements. The ratio is the essence of the case and thus may not always be found simply by quoting from one judgement. Discovering the ratio will involve skills of construction, interpretation, understanding and explaining what judges meant, how they reached their conclusions, in order to see the common grounds of judicial interpretation. Although the ratio is the law, it cannot be divorced entirely from the facts. Facts which are essential for a decision provide the conditions for the operation of the rule and are, thus, part of the rule itself.

A Court must follow the ratio of any relevant case which is binding on it under the doctrine of precedent. Thus, the question arises, when is a case relevant? A case in the same area must be followed unless it can be distinguished on the basis of its facts. If the facts of the case cannot be distinguished, if the case is 'on all fours', then it must be followed. The process of distinguishing cases is really just another way of deciding what the ratio of the case is. If the material facts necessary for the operation of the legal rule in the first case are not found in the second, or are different, there is no precedent.

The judge may go on to speculate what his interpretation or decision would or might have been if the facts of the case had been different. This is the *OBITER DICTUM*: something said by the way. That which is not part of the ratio of the case is said to be the *obiter dictum*. The binding part (if any) of a judicial decision is the ratio decidendi.

An obiter dictum is not binding in later cases because it was not strictly relevant to the matter in issue in the original case. However, an obiter dictum may be of persuasive (as opposed to binding) authority in later cases. That which was said obiter dictum in a Court such as the House of Lords may be very persuasive indeed for a relatively inferior Court such as a County Court. Moreover, remarks made obiter may indicate which way the law is developing or which kinds of arguments judges find particularly persuasive. Very often where an obiter is involved, there will be no counsel's interpretation on it as it will be outside counsel's focus.

Hence, judicial interpretation is, using the words of Gray (1924):

"The process by which a judge constructs from the words of a statute-book a meaning which he either believes to be that of the legislature [laid down by precedent] or which he proposes to attribute to it"

(p176)

This section has sought to analyse the basic approach of the judges in the interpretation of statutes. It addressed the question of what the judges are seeking to interpret, and especially what is the relationship they conceive between the text of a statute and the intention of Parliament. The application at the subsequent mini judicial sections will focus on the judicial interpretations of the bracketed statutory provisions on the auditor's duties.

6.2.1.5 SUB CONCLUSION

This section has sought to open up four of the basic 'rules' concerning statutory interpretation, namely literal, contextual, purposive and judicial. The literal rule seeks to obtain the ordinary plain meaning from the words used on its own. The contextual rule expands on the literal meaning by referring to the rest of the Act. The purposive rule turns to the statutory objective or the actual intention of the Parliament in the enactment. Finally, the judicial rule refers to the meanings arrived at by the judiciary system.

The rules are explored with all the diffidence and reservation that the subject demands. Which 'rule' takes precedence when conflicting interpretations emerge on the same statutory provision? No guidance can be derived from a statute. The Interpretation Act 1978, like its predecessors contain no general principles on this issue. There is no

binding judicial decision on the subject of statutory interpretation generally as opposed to the interpretation of particular statutes. Such is the uncertainty facing the 'rules'. All that there is, according to Bell and Engle (1987) is a welter of judicial dicta which vary considerably in weight, age and uniformity.

Nevertheless, this question will be answered in the next chapter after a further understanding and insight has been gained on this subject area.

6.2.2 CODING

The deciphered meanings of the bracketed texts need to be coded to assist in further analysis and interpretations. This categorical approach is a movement beyond the ad-hoc classification where no attempt is made to fit classes to data so that relations between variables and dimensions can be summarised. The coding here as seen in Figure 6.3 consists of a system of classes constructed (source of auditor's duty vs role) to fit the subject matter so that relationships among the classes can be described.

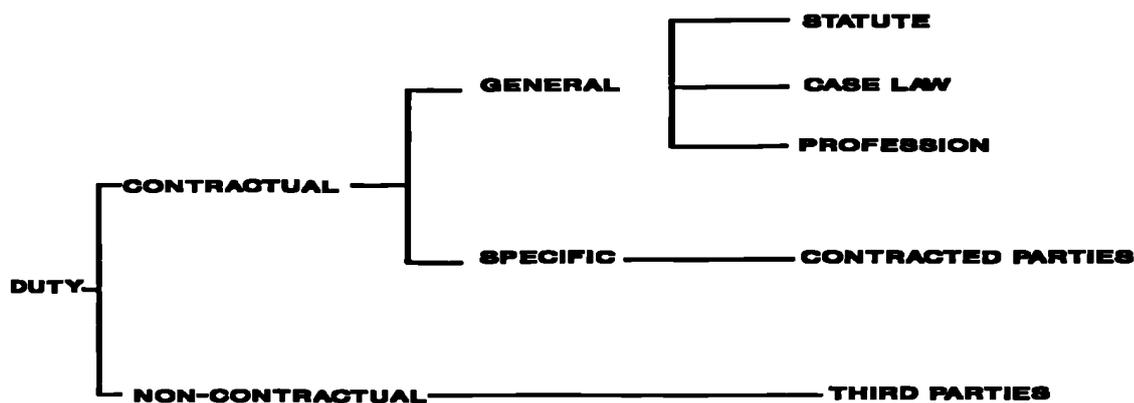
On one axis, the source of the auditor's duties is arranged in a descending order of legal authoritativeness, from statute law to third parties. The auditor's duties are first and foremost regulated and dictated by Parliament via statute law. This is followed by case law whereby the Courts, subservient to Parliament, can lay down duties for the auditor, with or without reference to statute law. Both statute and case law constitute the 'law' as we traditionally know it. Next comes pronouncements from the profession in the form of Auditing Standards and Guidelines for the auditor. Though such pronouncements are not 'law', they are quasi-law in that a Court of law when considering the duties of the auditor may take into account such pronouncements as indicative of good practice. Auditors, who are members of the professional bodies are also expected to follow such standards in the conduct of an audit, otherwise they can be subjected to disciplinary action. Then there are also contracted duties made in private between auditors and their clients. For the sake of completeness, there is also a limited social duty to third parties which comes under tort and negligence.

The auditor in fulfilling his general contractual duties for registered companies will firstly need to ensure that his statutory requirements in the Companies Acts are carried out, followed by any subservient case or common law which may interpret the Companies Acts, thereby clarifying the auditor's statutory duties. The 'law' needs to be abided

first. The auditor would next need to abide by the professional pronouncements of the Institute of which it is a member and thus subjected to, which has been referred to as quasi-law in this case. For the profession may further interpret or clarify the statutory or case law duties. The statute, case law and professional requirements would apply to all audits generally.

The auditor's client may then request extra requirements into the general audit via a specific contract which may further extend the scope of the audit. After satisfying all the 'general' requirements, the auditor now has to be concerned in fulfilling these 'specific' requirements under contract. Finally, the auditor can have a limited duty of care to third parties with whom s/he has no contractual duty but one remotely under tort.

The diagram below summarises the above framework for the codings 1 to 5.



Thus, the status of the hierarchy of regulation on the auditor is ranked numerically in the order of the general contractual requirements (statutory, case law, professional), specific contractual requirements and third party non-contractual responsibilities under tort.

On the other axis, the role is distinguished between an explicit (higher) and implicit (lower) duty. A duty towards fraud detection becomes explicit (category 'a') when the words 'fraud detection' are used or stated expressly by the respective sources. In the absence of such explicit reference one would then consider if there is an implicit (category 'b') duty by reference to any inferred words used which may have

connotations with fraud detection such as 'corrective', 'protection' etc. The implicit duty is seen as a duty willed beyond the explicit message. In the absence of an explicit or implicit statutory duty to detect fraud or the presence of an explicit expression to the contrary, it would then be prudent to relegate by implication to a lower level, which would normally be that of a contractual duty to be arranged privately between the parties (level 4b). This would be considered to be a reasonable and a safe conclusion, in the absence of common law and professional inference. The process will be made much more evident in the subsequent sections when it is being shown how it is applied empirically to a particular situation.

The various classes when combined creates a coding system for the hierarchy of regulated responsibility facing the auditor towards fraud detection. Such a system bears a close relationship to empirical reality. Sub classes were further introduced to facilitate that isomorphism.

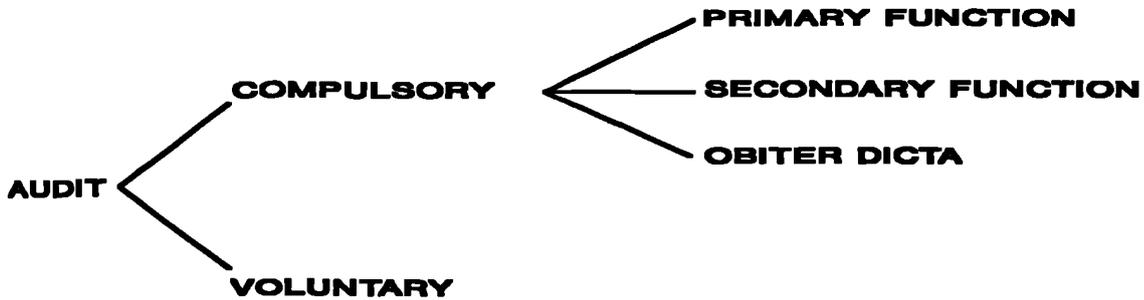
The restricted (r) sub-classes refer to the expressed provisions in the Companies Acts, in Hansard or in judicial pronouncements. It moves from a more general duty (r_1, r_2) to a more specific duty (r_3, r_4, r_5). The more general the restriction (eg r_1), the wider the duty and thus the more onerous that duty the higher the level it is placed.

Next comes the secondary (s) function. This term is used (somewhat loosely) when it was expressed as the second objective of the audit in the House of Commons (as in CA 1967) or when the explicit main aim of the audit was to verify the disclosure requirements but there was some resistant view (by some members in either House) that the audit still had some detection role (as in CA 1981). In the case of a combined secondary and implicit coding, it refers to the 'secondary function' of the audit which has not expressly used the words 'fraud detection' but words which can imply a fraud detection duty (eg secondly [referring to the second objective of the audit], it should be designed to protect the shareholder from fraud).

Next comes the obiter dicta (o) duty which carries with it only persuasive (not binding) authority and can be a faint indication of the way the law is developing.

Finally, outside the realm of the compulsory statutory audit, comes the voluntary statutory audit.

The diagram below summarises the above framework for the sub-classes.



In one sense, these classification are more nominal than ordinal since they have been designed primarily to facilitate the visualisation of change taking place and to highlight the differing definitional interpretations that could emerge under the different rules.

Such taxonomies perform several functions for the researcher. Firstly, they specify a unit of social systems (Parsons and Shils, 1959) to be analysed and indicate how that unit may be described (Zetterberg, 1965). Such definitions tell the researcher what to look for, but they are primarily descriptions, not analytical explanations. Thus, the second function of the taxonomy is to summarise and inspire further analysis.

The bracketed texts are now ready for coding. It may be necessary to refer back to the relevant Companies Acts in section 5.2 to assist in the process of the codings.

Figure 6'3: HIERARCHY OF REGULATION AND RESPONSIBILITY FOR THE AUDITOR

SOURCE	ROLE	EXPLICIT (= a)	IMPLICIT (= b)
1 Statute		1a	1b
2 Case Law		2a	2b
3 Profession		3a	3b
4 Contracted Parties (in privity)		4a	4b
5 Third Parties (not in privity)		5a	5b

Further sub classes:	(r ₁)	=	restricted to reasonable care and skill
	(r ₂)	=	restricted by materiality
	(r ₃)	=	restricted to the books and supporting documentation
	(r ₄)	=	restricted to the books and information/explanations given
	(r ₅)	=	restricted to the books
	(s)	=	secondary
	(o)	=	obiter dicta
	(v)	=	voluntary

6.3 JOINT STOCK COMPANIES ACT 1844

6.3.1 LITERAL INTERPRETATION

Based on s41, it appears that the auditor's duties are to CONFIRM the accounts and report specifically if it is not PROPER to do so. What do the key words 'confirm' and 'proper' mean here?

Though s3 (Construction of Words section) exists within the Act, which seeks to assign meanings to certain words and expressions, the words 'confirm' and 'proper' are not on the list. The Interpretation Acts of 1850, 1889 and 1978 are also silent on the words.

One then resorts to the Shorter Oxford Dictionary for some clarification.

CONFIRM	(1297)	: To make valid by formal authoritative assent, to ratify, sanction
	(1485)	: To strengthen (in an opinion, action or purpose)
	(12-15thC)	: To corroborate, to verify, put beyond doubt
PROPER	(1150-1350)	: Adapted to some purpose or requirement - fit, apt, suitable, fitting, befitting, especially appropriate to the circumstances
	(1738)	: In conformity with the demands or usages of society, decent, decorous, respectable, correct

'Confirm' appears to bring forth an affirmation duty here, though the last definition with the words 'put beyond doubt' seems to introduce a slight indication of fraud detection. 'Proper' on the other hand, leads to the meaning that the accounts are to be confirmed according to some suitable purpose or requirement. What that requirement is, is not evident from the section above. But the later definition on 'proper' seems to bring forth the societal requirement that it is respectable or correct, which implies that the accounts are not to be incorrect due to fraud or errors.

There is no explicit mention of the word 'fraud detection' in s41. But the combination and literal usage of the words 'confirm' and 'proper' in the statutory provision (ie level 1) seem to infer an implicit duty (ie level b) to detect fraud. Hence level 1b.

6.3.2 CONTEXTUAL INTERPRETATION

The literal interpretation per se does not clarify enough the scope of the affirmation duty. To do so, one needs to resort to the context and other sections of the Act.

s35 *"And be it enacted, that fourteen days at the least before the period at which the accounts are required to be delivered to the Auditors as herein-after provided, the Directors of such company shall cause the Books of the Company to be balanced, and a full and fair Balance Sheet to be made up..."*

By incorporating the context of s35 to s41, the auditors are required to confirm that the Accounts and Balance Sheet are full and fair. That is the scope of the affirmation and the context to the word 'proper'. But what does the phrase 'full and fair' mean? One needs to apply the literal rule again.

As with the word 'confirm', the phrase 'full and fair' is not listed in s3 (Construction of Words section) nor in the Interpretation Acts.

The Shorter Oxford Dictionary defines the following words:

FULL (c 1150) : Abundant, copious, satisfying, satisfactory
(1656) : Complete or abundant in detail

FAIR (c1150-1350) : Free from bias, fraud, or injustice, equitable, legitimate

From the definitions given here, it seems that the auditor has to confirm that the accounts are satisfactory, complete in detail and free from fraud. Also both the statutory sections 35 and 41 (ie level 1) were enacted under the headings 'Regulation of Companies' in the Act. The further contextual provision of s35 makes no specific reference towards a duty to detect fraud (ie no explicit duty) but the phrase 'full and fair' does carry implicitly such an inference (ie level b). In context of regulation and confirming that the accounts are full and fair, it appears that the auditor has an implicit duty to detect fraud (ie level 1b), based on the contextual interpretation.

6.3.3 PURPOSIVE INTERPRETATION

A Select Committee was appointed specifically *"to inquire into the State of the Laws respecting Joint Stock Companies (except Banking Companies) with a view to the greater security of the public"* (Gladstone Committee Report 1844, p3).

In further pursuance of this objective, the Select Committee thought it desirable notwithstanding the notoriety of the circumstances which had attended the concoction, progress and termination of some bubble companies, to receive evidence of ten remarkable cases of miscarriage or fraud, with a view to practical remedies to be specifically directed to such cases. With the evidence gathered the Select Committee categorised the bubble Companies into three classes. Of relevance here is the second category: *those which let their objects be good or bad, are so ill constituted as to render it probable that the miscarriages or failures incident to mismanagement will attend them* (ibid, p4).

Here the Gladstone Committee reported that the character and credit of persons engaged in companies of this second class lull suspicion. The directors themselves are often indifferent and careless, trusting too much to their officers; shareholders purchase on the strength of their names without due inquiry, and thus confer factitious support so that one set of persons relying upon another set, the delusion is sustained for a longer space of time.

The Select Committee expressly noted that publication of the directors and shareholders, of Deeds of Settlement and of the capital, will not meet this class of cases; but it may be met by the periodical holding of meetings, by the periodical balancing, audit and publication of accounts, and by making the directors and officers

more immediately responsible to the shareholders, which may probably be accomplished by facilitating and improving the remedies available to Joint Stock Companies and their shareholders inter se. It was emphasised by the committee that periodical accounts, if honestly made and fairly audited, cannot fail to excite attention to the real state of a concern; and by means of the improved remedies recommended, parties to mismanagement may be made more amenable for acts of fraud and illegality.

Thus in drafting of the compulsory audit requirement (s38) into the Act itself, one needs to trace back to the second category of bubble companies. The common law (ie the legal position) before the Act was that audits were not made compulsory. The enactment of the audit was intended primarily to remedy the mismanagement through indifference, carelessness and over confidence on the part of the (honest) directors which subsequently promulgated fraud to be committed by their 'trusted' officers.

The purpose of the audit was not primarily to prevent or detect fraud but to overcome mismanagement. Fraud was the consequence of poor management. Fraud detection thus became the secondary objective [ie category (s)] of the audit. The statutory audit (ie level 1) was to make the parties to mismanagement 'more amenable for acts of fraud and illegality'. How that is done is not mentioned but one can only interpret by implication that it probably would involve fraud detection by the auditors (ie level b).

From this purposive analysis of the legislature, it seems that auditors have only a secondary implicit duty to detect fraud. Hence level 1b(s).

6.3.4 SUMMARY

	LEVEL
Literal Interpretation	1b
Contextual Interpretation	1b
Purposive Interpretation	1b(s)

6.4 JOINT STOCK BANKS ACT 1844

6.4.1 LITERAL INTERPRETATION

The only reference to auditors' duties in this Act is to perform an independent annual AUDIT. What does the key word 'audit' mean here?

The Interpretation of Words section within the Act (s44) offers no help at all since the word 'audit' is not provided there. The other Interpretation Acts of 1850, 1889 and 1978 are also silent on the word.

Reference is now made in the Shorter Oxford Dictionary for some assistance.

AUDIT (1557) : To make an official systematic examination of (accounts)

Here, the audit is seen as an examination of the accounts. It does not clarify the extent of that examination. Does it include examination for fraud? There is no explicit or implicit mention of fraud detection. It is difficult to say literally whether such a duty is expected on the statutory level. In terms of prudence one can only safely relegate it to a private contractual duty. Based on the ordinary meaning, one can only reasonably infer (ie level b) that fraud detection needs to be arranged privately between the parties in contract (ie level 4). Hence level 4b.

6.4.2 CONTEXTUAL INTERPRETATION

Other sections of the Act are silent as regards the audit and the extent of that examination. Hence, it is of no avail here. The meaning remains at the literal level of 4b.

6.4.3 PURPOSIVE INTERPRETATION

There were three Parliamentary Reports (Peel Report 1836, Select Committee Report 1837, Select Committee Report 1837-38) prior to the drafting of the Joint Stock Banks Bill. Only the Peel Report (1836) touched on the issue of the appointment of auditors. The following is a relevant extract from the Minutes of Evidence taken before the Peel Committee.

Q 1518 [Mr Morrison] *"Would not the appointment of auditors be a proper safeguard against any improper and improvident act on the part of the bank?"*
[Mr V Stuckey, Banker] *"I think it might"*

This question sought to expand a little on the scope of protection afforded by the auditors; namely the safeguarding against any improper and improvident acts by the bank. This was replied in the cautious but affirmative note.

Mr Gladstone may have probably summed up the contemporary view when in the House of Commons Debate (Session 28 June 1844 col 101) on this Act, he said that the duties of an auditor were properly corrective and retrospective.

It seems that the audit was introduced into the joint stock banks to provide some protection against fraud. Words stated above in conjunction with the statutory provision (ie level 1) such as 'improper', 'improvident' and 'corrective' seems to have a strong connotation with fraud. It is likely that one of the purpose of the legislative audit implied above is to detect fraud (ie level b), amongst other purposes. Hence the level allocated here is 1b.

6.4.4 SUMMARY

	LEVEL
Literal Interpretation	4b
Contextual Interpretation	4b
Purposive Interpretation	1b

6.5 JOINT STOCK COMPANIES ACT 1856

6.5.1 PREFACE

In 1856, the Companies Act here abandoned the compulsory audit provisions of the 1844 Companies Acts, substituting instead voluntary protective provisions giving:

- a) the Board of Trade the right to investigate the financial affairs of a company should at least one-fifth of the shareholders, in number and value, invite it to do so (s48);
- b) the shareholders in a general meeting to appoint casual inspectors to examine the affairs of the company (s51); and

- c) the shareholders in a general meeting to appoint an auditor under cl 74 Table B of the Act which outlined a model set of Articles of Association for adoption by any company not wishing to produce its own (s9).

The focus here will be on the last provision, in trying to ascertain the level of fraud detection responsibility when a voluntary audit has been adopted under Table B. Hence, all the codings here will have a category (v) attached to it.

6.5.2 LITERAL INTERPRETATION

Based on the ordinary literal construction of the wordings in the two clauses, the auditor has to ascertain the 'correctness' of the balance sheet (via examination of the accounts) (cl 74), which is expanded in cl 84 to mean 'full and fair'.

Definitions in the Act and the Interpretation Acts have not sought to define the term 'full and fair'.

The Shorter Oxford Dictionary is then resorted to:

FULL (1656) : Complete and abundant in detail

FAIR (c1150-1350) : Free from bias, fraud or injustice; equitable, legitimate

The word 'full' requires the balance sheet to be complete in relation to some detail. If one reads on further in cl 84 after the word, it seems that the details are "*the particulars required by these Regulations*". The 'particulars' are explicitly stated in Table B - cl 72 as follows:

"A Balance Sheet shall be made out in every year and laid before the General Meeting of the Company, and such Balance Sheet shall contain a Summary of the Property and Liabilities of the Company, arranged under the Heads appearing in the Form annexed to this Table (B), or as near thereto as circumstances admit"

The word 'full' relates to the format and the contents of disclosure in the balance sheet.

The word 'fair' has connotations with the balance sheet being equitable and free from fraud. With such further clarification, one can proceed to read further into the sentence construction of cl 84 which links 'full and fair' to 'a true and correct 'view'. The Shorter Oxford Dictionary defines:

TRUE (c1150-1350) : Consistent with fact; agreeing with reality, representing the thing as it is

CORRECT (1705) : In accordance with fact, truth or reason, right

Both words seem to convey the meaning that it is consistent or in accordance with fact or reality.

The three words 'fair', 'true' and 'correct' all appear to have connotations with the absence of fraud to some degree in the audited balance sheet (ie level b). It is difficult to draw out any meaningful conclusions for "*satisfactory explanations or information*" since what is 'satisfactory' is very subjective. Nevertheless there appears to be an implicit statutory provision (ie level 1) for the auditor to detect fraud if Table B is adopted. Hence level 1b(v).

6.5.3 CONTEXTUAL INTERPRETATION

In attempting to read into the auditor's duties under Table B, cl 84 states that the auditor shall report on the balance sheet and accounts. Whilst the extent of the report on the balance sheet is clarified to some extent within the clause; as regards the report on the accounts, it is fairly evasive.

Looking at Table B - cl 69 which states the condition the accounts are to be kept (and reported on) may provide some contextual meaning to it.

"The directors shall cause true accounts to be kept, - of stocks in trade and the Company; of the sums of money received and expended by the Company and the matter in respect of which such receipt and expenditure takes place; and of the credits and liabilities of the Company."

Hence, the Auditor has to report on the 'correctness' of the balance sheet and if 'true' accounts are kept by the directors. Based on the definitions of 'correct' and 'true'

relating to the absence of fraud as explained in the previous section, it appears that the auditor has an implicit duty to detect fraud (ie level b), even under the contextual interpretation of the statutory provisions (ie level 1). Hence level, 1b(v).

6.5.4 PURPOSIVE INTERPRETATION

No Select Committee was set up for this Act, but there were discussions both in the House of Commons and House of Lords on the radical reforms drafted into the Bill; one of which was the abandonment of the concept of compulsory company audits.

There was the belief that investors ought to be responsible for their own protection and look after themselves.

"The Act for the Registration of Joint Stock Companies was passed at a time when much of the experience they now possessed had not been obtained, and it contained many provisions of super-abundant prudence, which really gave no protection against the evils they now sought to remedy, but created a fictitious security in the minds of the public, by inducing them to trust to Parliament instead of exercising that caution which they alone could effectually use"

(Mr R Malins, House of Commons, Session 1 February 1856 col 145)

"It was the business of all persons to protect themselves. People ought not to embark on joint-stock undertakings without taking the ordinary precautions with the view of ascertaining whether or not those who launched them were men of respectability and substance; and he thought that if men would rush blindfold into matters of that kind, it would be impossible to protect such fools from the consequences of their folly."

(Viscount Palmerstone, House of Commons, Session 26 May 1856 col 636)

Subsequently there was some opposition to the House of Commons view as stated by Viscount Palmerstone above. Lord Alverstone in the House of Lords on 24 June 1856 protested repeatedly against the course to be adopted by the Government and urged that it was not right that the legislature should refuse to impose any safeguards upon Joint Stock Companies, but leave every man to the exercise of his own discretion.

Nevertheless, Lord Stanley of Alderley managed to bring the House of Lords back to the Government's view. He said: *"instead of treating the whole public as children who could not take care of themselves, it was better to leave these matters to the judgement of the public, who would then act like grown-up sensible men and would not be deluded by the false security supposed to be imposed by a number of fallacious*

restrictions which did no good, but encouraged and created the frauds which they were supposed to prevent". (House of Lords, Session 24 June 1856 col 1893).

In conclusion, the Government held the explicit view that the statutory audit 'really gave no protection against the evils' and that 'all persons (are) to protect themselves'. There is thus no expectation by the Government of a fraud detection duty at the statutory level. It seems at the end of all this and based on the laissez-faire contemporary feeling, that if fraud detection was desired, it should be contracted between the parties in privity (ie level 4). It was also stated explicitly that it is 'better to leave these matters to the judgement in the public' (ie level a). The most appropriate level would be 4a(v).

6.5.5 SUMMARY

	LEVEL
Literal Interpretation	1b(v)
Contextual Interpretation	1b(v)
Purposive Interpretation	4a(v)

6.6 COMPANIES ACT 1862

The wording of the relevant sections is nearly identical to the relevant sections of the Joint Stock Companies Act 1856 (Table B - cl 74&84). The audit is still voluntary. Hence, all codings will have a category (v) attached to it.

6.6.1 LITERAL INTERPRETATION

The same key words of 'correctness', 'full and fair' and 'true and correct' are repeated here. The Definitions Section did not define the above words. As was analysed previously (see s6.5.2), the literal interpretation of these words conveyed an implicit statutory duty for the auditor to detect fraud if Table A is adopted. As the provisions are identical here and the audit is still voluntary, the level remains at 1b(v).

6.6.2 CONTEXTUAL INTERPRETATION

Directors still have to keep true accounts here (Table A - cl 78). Hence the contextual interpretation is still the same as in the previous Act and as above: level 1b(v).

6.6.3 PURPOSIVE INTERPRETATION

No Select Committee was set up prior to drafting this Act and there were very few recorded debates in the Parliament.

The only related information found was when the Lord Chancellor, Lord Westbury (House of Lords, Session 21 July 1862 col 586) in moving for the second reading of this Bill commented briefly that there was difficulty in providing facilities for the formation of companies, combined with proper safeguards. This point was not taken up further.

In this situation, the purposive view seems to be static since the 1856 Act. In view of the audit still being made voluntarily coupled with no new purposive insights, fraud detection remains in Parliament's view to be contracted between the parties in privity. Hence level 4a(v).

6.6.4 JUDICIAL INTERPRETATION OF *LEEDS ESTATE, BUILDING AND INVESTMENT CO v SHEPHERD (1887) 36 Ch D 787*

6.6.4.1 COUNSEL'S (FOR THE PLAINTIFF) INTERPRETATION

Counsel said:

"According to his (auditor) own admission, he never looked at the Articles of Association of the company to see what the duties were which he was paid by the company to perform. But this is no excuse; he must be taken to have known what such duties were, and it is quite clear that he did not discharge them, and that his certificates were untrue.

It is for the precise purpose of protecting a company from errors, innocent or otherwise, that an auditor is appointed. His duty is not merely to see that the balance sheet correctly represents what appears in the books. His duty is to check the directors and manager.

Locking, the auditor, failed to perform his duties as defined by the Articles of Association; even if he had no actual knowledge that the balance-sheets were false. Had he performed his duties with ordinary diligence, these illegal payments would not have been made out of the capital of the company; and he is liable for the loss which is the direct consequence of his failure to perform the duties of his office."

(35 Ch D 796-797)

Under the provisions of the voluntary audit, the company lays down the auditor's duties in its Articles of Association. In this case, the terms are identical to Table A - cl 83&94. Counsel interpreted it that the auditor has the precise purpose of protecting a company from non-innocent errors (ie fraud). His duty is to check the directors and manager. He claimed that if the auditor had performed the duties of his office, the fraud (illegal payment) would have been detected. Counsel is saying that the illegal payments were made as a direct consequence of the auditor's failure to perform the duties of his office as interpreted into the Articles resembling the statutory model (ie level 1), imply that the Articles carry a duty on the auditor to detect fraud (ie level b). Thus level 1b(v).

6.6.4.2 COUNSEL'S (FOR THE AUDITOR) INTERPRETATION

Counsel quoted the judgement of Lord Chelmsford in *Spackman v Evans (1868) Law Rep 3 HL 171* that it is no part of the office of an auditor to inquire into the validity of any transaction appearing in the accounts of the company.

"(Auditor's) duty was to see that the balance sheet represented and was a true result of what appeared in the books of the company; and his certificate goes no further than that. The auditor is a machine for this purpose only, and a true balance sheet from his point of view is one which shows correctly what appears in the company's books. He cannot go behind the books of the company. The inconvenience of requiring more from an auditor is obvious...There was no negligence on his part.

(Auditor) was employed at an annual fee, which at first was only 5 guineas, and never was more than £12, and was given for the performance of work of a particular character...Having regard to the amount of an auditor's remuneration, it would be one of the most alarming and ill-paid of occupations if he were to be liable..."

(36 Ch D 795-796)

Counsel has personally interpreted (without reference to the Articles or the statutes) the auditor's duties as only to see that the balance-sheet was a representation of what was recorded in the books. He claimed that the auditor cannot be expected to go behind what is unrecorded to detect fraud. The other argument put forward was that the ill-paid remuneration would not commensurate with the higher duty to detect fraud. It

appears implicitly (ie level b) from the above reasoning that counsel saw the fraud detection duty as something to be arranged specifically between the parties to the contract (ie level 4), and not under the ordinary audit, hence level 4b(v).

6.6.4.3 HIGH COURT JUDGE'S INTERPRETATION

His Lordship stated as ratio decidendi that:

"It was in my opinion the duty of the auditor not to confine himself merely to the task of verifying the arithmetical accuracy of the balance-sheet, but to inquire into its substantial accuracy, and to ascertain that it contained the particulars specified in the Articles of Association (and consequently a proper income and expenditure account) and was properly drawn up, so as to contain a true and correct representation of the state of the company's affairs.

*It appears...that the duties of the auditor as defined by the Articles of Association were not in reality discharged by him...(hence) guilty of a breach of duty to the company."
(36 Ch D 802-3, 809)*

Later on the judge described it as an imperfect audit carried out. He held the auditor liable for failure to detect the illegal payments (fraud) in ascertaining 'a true and correct' view by implication from the Articles (ie level b). He went along with the counsel for the plaintiff's view. But because the company's Articles were identical to the statutory Articles, the judge also gave judicial precedent for the interpretation of the voluntary statutory provisions (ie level 1). Hence level 1b(v).

6.6.4.4 SUMMARY

	LEVEL
Literal Interpretation	1b(v)
Contextual Interpretation	1b(v)
Purposive Interpretation	4a(v)
Judicial Interpretation	1b(v) [Counsel for plaintiff's interpretation] 4b(v) [Counsel for auditor's interpretation]

6.7 COMPANIES ACT 1879

6.7.1. LITERAL INTERPRETATION

The audit of banking companies only is being reintroduced as compulsory here. Under this Act, the auditors are expected to 'examine' the accounts and report on them and the balance sheet. Whilst it is silent as to the wording of the report for the accounts, it does state expressly for the balance sheet that the report should state if it is 'full and fair'. This was referred to later in the section as 'true and correct', on the basis of the books of the company.

Firstly, what are the auditors expected to do in examining the accounts, in the absence of guidance as to the wording of the report on it?

The Act is silent in interpreting it with no Definition Sections and the Interpretation Acts also offer no help. The Shorter Oxford Dictionary is the next resort.

EXAMINE (c1350-1450) : to try by a standard, to investigate by inspection, to inspect in detail, scan, scrutinise

It seems to be an inspection on the basis of some standard set. What that standard is in conjunction with the accounts cannot be determined from the wording of the relevant sections per se.

On the other hand, the scope of duty on the balance sheet is clarified by the draftsman. The standard set here is a 'full and fair' balance sheet, which was re-explained as 'true and correct'. The literal meanings of these words have been discussed in some length in s6.5.2 The literal conclusion reached there was an implicit statutory duty to detect fraud. The same conclusion can be made here.

But in this case, the detection of fraud is restricted to what is 'shown by the books of the company' [ie category (r₅)]. The auditor is not expected to go beyond the books. Hence the level of responsibility here is 1b(r₅).

6.7.2 CONTEXTUAL INTERPRETATION

This is a very short Act with only ten provisions in it. How the accounts are to be kept were not mentioned in the provisions.

As this is only an Amendment Act, one could refer to the earlier Companies Acts to provide for some contextual guidance. It seems to be that directors have to keep 'true' accounts (Table A - cl 78, Companies Act 1862). That appears to be the basis for the standard of examination in the accounts.

The Shorter Oxford Dictionary defines 'true' as: consistent with fact, agreeing with reality, representing the thing as it is (c1150-1350). Based on this clarification, it seems to say by implication that if something is 'true', it is not false or fraudulent in relation to the facts or reality.

As regards the balance sheet audit, the other provisions in the Act do not provide any further insight. Hence the literal meaning remains unmodified.

The further contextual insight given to the examination of the accounts by the word 'true' only reinforces the literal interpretation of an implicit duty to detect fraud on 'the books of the company'. Hence level 1b(r₅).

6.7.3 PURPOSIVE INTERPRETATION

The Chancellor of the Exchequer, Sir Stafford Northcote, said in the House of Commons (Session 21 April 1879a col 791) that *it cannot be denied that the alarm which has been excited and the consideration which have been brought forward in consequence of the Glasgow Bank fraud have opened our eyes to some defects and inconveniences in the law which at present affects joint stock companies, and especially joint stock banks.*

The common defect was highlighted strongly and clearly by both House of Commons and Lords.

"One thing was to be noted in all these bank failures. I believed not a single bank had failed for years past which had a good and thoroughly satisfactory audit. Neither the City of Glasgow Bank, nor any of the banks (eg West of England Bank) which had been

subject to comment lately, ever was audited by auditors who were independent of the directors, and who were sufficiently remunerated to do their work thoroughly. If they gave their auditors £50 to audit the accounts of a bank with 20 branches, they might expect to have an audit which was worth nothing; but if they gave them 500 guineas, and encouraged them to make their auditing thorough, then, he believed that an audit by public accountants was an effectual security against any public disaster, and the most effectual security that could be devised"

(Mr Lloyd, House of Commons, Session 21 April 1879 col 806)

"Many of your Lordships will remember that in 1855, the question of an independent audit was considered; and in my opinion, if there had been an independent audit of the City of Glasgow Bank accounts, the disaster which is deplored by so many thousands, and which has ruined so many families, would not have occurred"

(Lord Denman, House of Lords, Session 14 August 1879 col 967)

This Glasgow Bank fraud immediately precipitated the Companies Act 1879 which reintroduced a compulsory audit only for all banks incorporated with limited liability. But then came the delicate task of deciding on the scope of the audit which was unusually raised at the first reading stage in the House of Commons; an indication of the seriousness of the scale of this fraud.

"All that we propose is that in every bank there should be a provision made of the appointment of an auditor or auditors, independent of the directors, who shall audit the accounts and publish the report certifying whether the accounts are given correctly, and disclose a true and fair statement of the accounts of the bank as shown by the books. It is impossible for an auditor to go into the books and say from them whether this is a good bill, or that is a good security. That is not only impossible to effect, but to attempt it would be delusive and dangerous. We keep free from that.

What we propose in the Bill is, that a proper examination shall take place of the books, and that the auditor shall declare, assuming their correctness, the statement of accounts is properly put together, and that it does give a full and fair description of the state of the bank."

(The Chancellor of Exchequer, Sir Stafford Northcote, House of Commons, Session 21 April 1879a col 799)

The scope of the audit and thus the auditor's duties were further elaborated in the Committee Stage in the House of Commons.

"It was undoubtedly true an independent auditor could not go through the securities held by a bank and put an accurate value upon them; but he would be able to prevent the fraud in such balance sheets as those which had been issued by the directors of the City of Glasgow Bank. If the banks were honest, this would be a check upon inaccuracies, but if they were dishonest, of course, it would be difficult for any audit to defeat them."

(Mr Cross, House of Commons, Session 29 July 1879a col 1562)

Mr Hankey, in the Committee Report stage (House of Commons, Session 12 August 1879a col 859) said it was impossible to prescribe by an Act of Parliament the form in which the auditors should manage their accounts. To which Mr Cross endorsed it strongly:

"...to put on an auditor the duty of stating the actual position of a bank was to put upon him what no human being could perform. But the clause imposed upon the auditor only the duty which an honest man could do - namely, of stating to the shareholders that to the best of his belief, the balance sheets submitted contained a full and fair statement of the assets and liabilities of the bank as these appeared from the books."

(House of Commons, Session 12 August 1879b col 857)

The debates from both Houses seem to point to the direction that the statutory audit (ie level 1) cannot be expected to detect all fraud and the duty of examination is restricted to the books of the company [ie category (r₅)]. It would be impossible and expecting too much from the auditor to go beyond the books. Fraud detection duty was much implied in the debates when it was argued that the audit was the most effectual security against any public disaster and that the Glasgow Bank fraud would not have occurred if there had been an independent audit (ie level b). Hence level 1b(r₅).

6.7.4 JUDICIAL INTERPRETATION OF RE LONDON AND GENERAL BANK (1895) 2 Ch 673

6.7.4.1 COUNSEL'S (FOR THE RESPONDENT) INTERPRETATION

Counsel for the respondent (official liquidator) argued that the duty of the auditors is plainly shown by section 7 of the Companies Act 1879 and the clauses in the Articles. The auditors are not only to verify the correctness of the entries in the books and the items in the balance sheet; they are *"to state whether in their opinion the balance sheet is a full and fair balance sheet properly drawn up so as to exhibit a true and correct view of the company's affairs as shown by the books of the company"* [s7(6) Companies Act 1879].

"The duty of auditors is to protect the shareholders against the directors, if they are misapplying the funds of the company....By standing by while the shareholders were deceived by the directors,...they ought therefore justly to be held liable."

(2 Ch 679-80)

Whilst Counsel held the view that the duty of the auditors is 'plainly shown' by the Companies Act and the company's Articles, it does imply that the statutory requirements on its own *per se* are not plainly shown. Under the literal interpretation section, it was highlighted the difficulty in determining what 'to examine the accounts' meant in the absence of further literal clarification from the provisions of the 1879 Act. It seems the London and General Bank Limited may have faced the same problem and drafted in additionally its own clauses in the Articles to clarify the statutory provisions. Counsel saw that the Articles seek 'to plainly show' what is not plainly shown in the statutes.

Having considered the requirements from statute (ie level 1), counsel came to the conclusion that the auditors are to protect against misapplication of funds and shareholders being deceived by the fraudulent directors. It appears from this that counsel feels strongly that the auditor has an implied statutory duty to detect fraud (ie level b). Hence level 1b.

6.7.4.2 COUNSEL'S (FOR THE AUDITOR) INTERPRETATION

Counsel for the appellant (auditor) claimed that it has never yet been decided (in the previous cases) what the exact character, nature, and extent of the duties of an auditor were. He went on:

"The directors are always on the spot and are the managers of the concern and quasi-trustees for the company. The auditor is not appointed to manage the concern, but to see that the balance sheet represents the state of the books. His duty is to examine the books, and he must accept those books as he finds them. He ascertains the cash at the bank, he asks for the vouchers, and sees that the securities are there. But it is a fallacy to contend that he is to ascertain whether too much credit has been given to anyone or that he is to judge or check the directors."

(2 Ch 678)

Counsel made the point that the exact extent of the auditor's duties has never been legally decided and hence whatever previous claims asserted should not be viewed as conclusive until the precedent is laid down. The fact that a lack of legal decision is raised here shows the level of clarity required in the wording of the statutory duties for the auditors, especially with regard to this Act.

He distinguished the auditor with the directors who are managers (ie having special knowledge of the company's transactions) and quasi-trustees (ie having a fiduciary

stewardship role). As the auditors are not engaged in running the business and without the special knowledge, he is to assume the books are correct. Counsel saw it a fallacy to expect the auditor to check on the directors, ie to detect fraud. As counsel sees by implication that there is no such statutory duty, the responsibility for detection is possibly relegated implicitly to level 4b (between parties in privity).

6.7.4.3 COURT OF APPEAL'S INTERPRETATION

The three Court of Appeal judges went on to great lengths to carefully consider what the duties of an auditor are as regards banking companies governed by the Companies Act 1879.

The following are some of the relevant abstracts from Lord Justice Lindley's judgement (with Lopes L J and Rigby L J concurring)

"...although clauses 107 and 114 [in the Articles] are in terms more explicit than s7 of the statute as regards the duty of the auditors to examine and ascertain the correctness of the statements laid before them, and of the accounts laid before the shareholders, yet it is tolerably plain from the language of s7(6) that the Articles add little, if anything to the duty imposed on the Articles by the statute alone...The Articles...remove any possible ambiguity to which the language of the statute taken alone may be open if very narrowly criticised"

(2 Ch 682)

"His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that. But...how is he to ascertain that position?...By examining the books of the company. But he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books themselves shown the company's true position. He must take reasonable care to ascertain that they do so. Unless he does this, his audit would be worse than an idle farce."

(2 Ch 682-3)

"But his first duty is to examine the books, not merely for the purpose of ascertaining what they do show, but also for the purpose of satisfying himself that they show the true financial position of the company. This is quite in accordance with the decision of Stirling J [in Leeds Estate Building and Investment Co v Shepherd, 1887]"

(2 Ch 683)

"An auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; he does not even guarantee that his balance sheet is accurate according to the books of the

company. If he did, he would be responsible for error on his part, even if he were himself deceived without any want of reasonable care on his part, say by fraudulent concealment of a book from him. His obligation is not so onerous as this"

(2 Ch 683)

"Such I take to be the duty of the auditor: he must be honest - ie, he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true. What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion very little inquiry will be reasonably sufficient, and in practice I believe business men select a few cases at haphazard, see that they are right, and assume that others like them are correct also. Where suspicion is aroused more care is obviously necessary, but still an auditor is not bound to exercise more than reasonable care and skill, even in a case of suspicion"

(2 Ch 683)

The balance sheet and profit and loss account were true and correct in this sense - that they were in accordance with the books. But they were nevertheless, entirely misleading, and misrepresented the real position of the company...Mr Theobald failed to discharge his duty to the shareholders...Possibly he did not realise the extent of his duty to the shareholders..."

(2 Ch 686)

Lord Justice Rigby had this to add:

"The Articles of Association cannot absolve the auditors from any obligation imposed upon them by the statute...Under the statute, the members of the company are entitled to have the safeguard of an expression of opinion of the auditors to the effect, first that the balance sheet is a full and fair balance sheet, and secondly that it, the balance sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs.

The words [s7(6) Companies Act 1879] 'as shown by the books of the company' seem to me to be introduced to relieve the auditors from any responsibility as to the affairs of the company kept out of the books and concealed from them but not to confine it to a mere statement of the correspondence of the balance sheet with the entries in the books. A full and fair balance sheet must be such a balance sheet as to convey a truthful statement as to the company's position. It must not conceal any known cause of weaknesses in the financial position, or suggest anything which cannot be supported as fairly correct in a business point of view"

(2 Ch 692)

This is a very rich case in its content and range of discussions but what is significant here are the various rationes decidendae which lay down the legal precedent for the auditors.

Lord Justice Lindley noted that the Articles were being drawn up to remove any possible ambiguity to which the language of the statute taken on its own may be read.

In response to the auditor's counsel that the exact extent of the auditor's duties has never been legally defined and the conflicting interpretations given by both counsel, the three judges have precisely sought to do that. Nevertheless, as Lord Justice Rigby noted: *"It may not be easy to define the full extent of the obligations which it (Companies Act) imposes"* (2 Ch 692).

What all this seems to be saying is that there has been and will be, ambiguity or uncertainty in defining the full duties of the auditors including for fraud detection. Lord Justice Lindley also noted that the auditor is to make a report to the shareholders but the mode of doing so and the form of the audit report is not legally prescribed. When cross-examined, the auditor replied that he was not aware that it was considered necessary for him to give the audit certificate either in the words of the Companies Act or not at all. Lindley L J sums it up quite well, *"Possibly he (auditor) did not realise the extent of his duty to the shareholders as distinguished from the directors"* (2 Ch 686).

Following from all this, legal precedent was laid down to clarify the auditor's statutory duties. All the judges agree that their first duty was to satisfy themselves that the books show the true financial position, though exercising only reasonable care and skill which varies with the circumstances of each case. The auditor is not an insurer since the Companies Act 1879 states explicitly that an opinion is required, not a guarantee. It did not help by calling the auditor's report, a certificate. But shareholders are entitled to have safeguards in an auditor's opinion. Another argument put forward by the judges was reasonable allowance/tolerance for human error on the auditor's side. An additional point worth noting is the reference by Lindley L J that the business community (including the auditors) select a few cases at haphazard as a basis for the conclusion of the whole population. This makes fraud detection even more difficult. But one wonders if such a statement did encourage the impetus towards audit sampling.

It was felt by the judges that it would have been too onerous to expect the auditor to detect carefully concealed fraud. The restricting statutory phrase 'as shown by the books' was clarified by Lord Justice Rigby to absolve the auditor from 'unknown' fraud kept out of the books and concealed but not 'known' fraud/weakness recorded in the books which could not be supported as fairly correct. It was not meant to ensure that the balance sheet was technically consolidated properly 'in accordance with the books'.

Lindley L J stated that the auditor should not be content with making his balance sheet from the books without troubling himself about the truth of what they showed but checked the cash, examined the vouchers for payment, saw that the bills and securities entered in the books were held by the bank and took reasonable care to ascertain their value.

But a higher duty to detect fraud arises when suspicions are aroused. It was interesting to note later on that Lord Justice Rigby used the less demanding words 'fairly correct' (as opposed to 'correct') in the context of the financial position to relate to a full and fair balance sheet. It may be that he was beginning to appreciate the difficulties in detecting all types of fraud as a consequence of the arguments presented earlier.

The conclusion reached at the end of all this is that this case has sought to offer judicially a review and clarification of the auditor's explicit statutory duties (ie level 1). There appears by implication to be some safeguard duty to detect fraud since it was stated by Lindley L J that the auditor does not discharge his duty without inquiry on examining the books and without taking any trouble to see that the books themselves show the company's true position (ie level b). He saw this legal standard of duty not too high for business purposes and was recognised as correct by businessmen.

Rigby L J emphasised that a full and fair balance sheet must convey a truthful statement of the company's position. And that duty is limited to reasonable care and skill in the light of the circumstances [ie category (r₁)]. In essence, there is an implicit statutory duty to detect fraud, restricted by reasonable care and skill. Hence this is a 1b(r₁) situation. This has actually opened up the understanding of s7 Companies Act 1879.

6.7.5 SUMMARY

	LEVEL
Literal Interpretation	1b(r ₅)
Contextual Interpretation	1b(r ₅)
Purposive Interpretation	1b(r ₅)
Judicial Interpretation	1b(r ₁)

NOTE

Counsel for auditor's interpretation = 4b
Counsel for respondent's interpretation = 1b

6.8 COMPANIES ACT 1900

6.8.1 LITERAL INTERPRETATION

The wording of s23 is closely similar to s7(6) of the Companies Act 1879, except for the removal of the redundant phrase 'full and fair' here. The auditor is still required to 'examine' the accounts and the balance sheet and report on a 'true and correct' balance sheet, but the audit now is made compulsory for all companies [s21(1)]. The Definitions Section of the Companies Act (s30) has not sought to define the meanings of such words.

Thus, the points raised previously in s6.7.1 on 'examination' and 'true and correct' also apply here again. In addition, the statutory requirement (ie level 1) of 'true and correct' was shown in s6.5.2 as carrying an implicit duty to detect fraud (ie level b). This literal duty is restricted here to the view 'as shown by the books of the company' [ie category (r₅)]. Hence the literal conclusion remains the same, ie 1b(r₅).

It is worth noting that s23 requires the auditors to certify whether 'all their requirements as auditors have been complied with'. It seems to imply that auditors know exactly what 'all their requirements are' which is unfounded. Do the requirements refer to statutory, judicial, professional, contractual or some combination of these? If interpreted narrowly as referring to statutory requirements, a literal interpretation on the basis of s23 will not clarify it without reference made to the other section numbers where these requirements are stated.

6.8.2 CONTEXTUAL INTERPRETATION

The other sections of this Act provide no further contextual insight to s23. As this is an Amendment Act, one could refer to the earlier Companies Acts to provide some contextual guidance. In there, directors have to keep 'true' accounts and that appears to be the basis for the auditor in the standard of examination required.

The points that one would raise here on the term 'true' have already been covered in the contextual section of the Companies Act 1879 (s6.7.2). Reference to that section will show that the conclusion reached there was for level 1b(r₅). Together with the literal conclusion above, this would only provide further comfort that the contextual level here should be 1b(r₅).

6.8.3 PURPOSIVE INTERPRETATION

According to the evidence given to the Davey Committee by Samuel Ogden, President of the Association of Trades Protection Societies, there appears to be widespread fraudulent abuse inherent in the limited status of companies. Below are some relevant extracts from the Davey Committee Report (1895).

"The proposals for the amendment of the law as to companies divide themselves into two branches, viz:-

- (1) As to the promotion and formation of companies; and*
- (2) As to the conduct of the business of companies after formation.*

The latter arises equally to all companies, however formed, which trade with limited liability, and has reference principally to the protection of prospective creditors...(namely) upon the principle that limitation of liability by registration ought not to be granted unconditionally but should, in the interests of the trading public affected by such limitation of liability, be accompanied by provisions for disclosure by the company from time to time of what is believed, by those responsible for its management to be its true financial position...The social and personal consequences of bankruptcy, which resulted from unlimited liability, impose prudence on private traders; but, being non-existent in the case of limited companies, business involving large risks is more easily undertaken by such companies"

(p65)

"I think it is necessary that the provisions as to audit and balance sheets should be statutory provisions, and not merely voluntary regulations made by the shareholders of each company. If such provisions affected shareholders only I should see no objection to leaving the provisions to them; but I think that the question of audit and balance sheets is of perhaps, greater importance in the interests of the trading community from which companies with limited liability obtain goods upon credit. Even as regards shareholders there is something to be said for making the [audit] provisions statutory and binding upon all companies."

(p69)

The Davey Committee embarked on drafting the Bill and laid down the general principles of suggested legislation. Below are the relevant abstracts from the Davey Committee Report (1895).

"Before inquiring into the typical form of fraud against which further protection is sought or the nature of the remedies to be applied, it is convenient to consider shortly the general lines upon which and the limits within which the legislature can safely or usefully interpose. It is a trite observation that legislation cannot protect people from the consequences of their own imprudence, recklessness, or want of experience. The legislature cannot supply people with prudence, judgement or business habits. It must be remembered that the majority of companies are honestly formed for carrying on a legitimate, though it may be a speculative enterprise or business and the business is conducted with honesty and reasonable ability and judgement"

(para 4)

"It is more difficult to lay down the lines upon which an amendment of the law respecting the administration of joint stock companies should proceed. There are two classes whose interests have to be considered, creditors as well as shareholders. Their interests, although diverse, are not necessarily adverse or in conflict. Both classes are interested in honest administration of the company's business, and it is upon the honesty and capacity of the directors and managers that in the long run reliance must be placed. It appears to (the) Committee, that more stringent provisions respecting audits, may be made with advantage and safety"

(para 7)

"The primary duty of the directors is towards their own shareholders and...the true financial position of the company should be disclosed to shareholders...(the) committee also recommend that the appointment of auditors shall be obligatory in all companies and they have attempted to define the duties of auditors as regards the books of the company and the balance sheet and other accounts presented to the shareholders"

(para 52&53)

The ethos of caveat emptor put forward by the Davey Committee was also echoed strongly in both Houses of Parliament.

Lord Dudley in the House of Lords (Session 19 March 1896) said,

It was true that no legislation however drastic, could absolutely shut out all possibility of fraud. A clever swindler would probably find his way through any Act of Parliament, and it was impossible to guard people against the consequences of their own folly or negligence"

(col 1317)

Mr Ritchie in the House of Commons (Session 26 June 1900) said,

"We ought to bear in mind that no legislation which we can undertake is at all likely to prevent mistakes in the management of companies which entails in many cases large losses. We cannot hope to prevent the imprudence or incompetence of managers. Neither can we attempt to prevent errors of judgment. Another thing I think it will be impossible for us to do by any legislation we can pass, is to protect investors from their own folly and carelessness...On the other hand, there is no doubt that the law ought,

as far as possible, to provide safeguards to protect the public against misleading or fraudulent devices or the fraudulent use of existing legal machinery"

(col 1140-1)

And safeguards indeed the Bill did introduce against fraud. There were provisions to prevent directors acting without share qualifications or taking gifts of paid-up shares, bogus or fictitious subscriptions; creditors made aware of mortgaged assets and the introduction of the compulsory audit. The Davey Committee (in paragraph 7) saw the audit (amongst other stringent provisions) as the answer to short-run honesty though in the long-run, the integrity and honesty of management is the greatest security of all. The services of the auditor were seen as combating fraud so that investors and creditors can safely invest their funds in a growing capitalistic economy.

At the royal assent stage in the House of Lords (Session 8 August 1900), Her Majesty, Queen Victoria said:

"The Bill for the regulation of limited companies and for the discovery of fraud in the conduct of them, will supply a want that has long been keenly felt"

(col 968)

From the evidence above, it seems that the purpose of the legislated audit (ie level 1) was to prevent the widespread fraudulent abuse of the privilege of limited status when companies go bankrupt at the expense of creditors and shareholders. It carries an explicit duty as seen in the Queen's speech to detect fraud (ie level a) but one limited to the books of the company (ie category (r₅)). Thus the purposive level is at 1a(r₅).

6.8.4 JUDICIAL INTERPRETATION OF *NEWTON v BIRMINGHAM SMALL ARMS COMPANY LIMITED (1906) 2 Ch 378*

6.8.4.1 COUNSEL'S INTERPRETATION

As this case concerns the auditor's duty towards the non-disclosure of the secret reserve fund, there are no relevant extracts here regarding fraud detection.

6.8.4.2 HIGH COURT'S INTERPRETATION

As the ratio of this case dealt with the issue of disclosure, the following extracts are the obiter dicta of the judgement.

Justice Buckley:

"The question is how far the Act of 1900 goes in requiring for the protection of the members that the accounts shall be open to audit and that a report shall be made to the members upon them...The concluding sentence of s23 requires that the auditor shall state whether the balance sheet exhibits a true and correct view of the state of the company's affairs as shown by the books...I think the language of the Act is sufficient to show that by implication it requires that there shall be annually an audit of the accounts resulting in a balance sheet, to whose accuracy the auditors shall speak"
(2 Ch 386-7)

That level of 'protection' and 'accuracy' was clarified further when he said: *"In reporting upon the accounts submitted to them, the auditors do not, of course, report as to the details of accounts to which they find no cause for exception. Their duty is to call attention to that which is wrong, not to condescend upon all the details of that which is right"* (2 Ch 388).

It seems that the judge saw the auditor's statutory duty (ie level 1) as raising the alarm if the accounts and balance sheet are 'wrong'; be it due to errors or fraud. In order for the auditor to be able to 'call attention' to that which is wrong, it implies that the auditor must have knowledge of the 'wrong' first. Hence, the obiter [ie category (o)] implies that the auditor has a duty to detect fraud (ie level b) . Hence, level 1b(o).

6.8.5 SUMMARY

	LEVEL
Literal Interpretation	1b(r ₅)
Contextual Interpretation	1b(r ₅)
Purposive Interpretation	1a(r ₅)
Judicial Interpretation	1b(o)

6.9 COMPANIES ACT 1907

6.9.1 LITERAL INTERPRETATION

Under this Act, the auditors are to 'examine' the accounts and to state expressly whether they have 'obtained all information and explanations required' and to give an

opinion of the balance sheet in 'true and correct' terms according to the best of the information and explanations given and as shown by the books.

The Act itself does not define any of the terms used above in its Definition Section and the Interpretation Acts also offer no help.

The first step is to ascertain what auditors are supposed to do in 'examining' the accounts. It is difficult to tell in view of the brevity expressed in s19(2). This problem was encountered in the Companies Act 1879 and it was concluded there, with the help of the Shorter Oxford Dictionary, to be an inspection on the basis of some standard(s) set. It was difficult to literally read further than that.

The next duty is to report explicitly whether they have obtained all information and explanations requested. This part appears more of granting powers to the auditor rather than clarifying his statutory duties.

The final duty is to report if the balance sheet is 'true and correct'. The literal meanings of these words were discussed in some length under the Joint Stock Companies Act 1856 (s6.5.2) whereby the conclusion there was an implicit statutory duty to detect fraud. It is proposed to adopt the same conclusion here (ie level 1b) in the absence of any new conflicting information. However, in this Act, that duty is reduced subject to the 'best of information and explanations given' and what is 'shown by the books' [ie category (r₄)]. Hence, the level of responsibility is 1b(r₄).

6.9.2 CONTEXTUAL INTERPRETATION

The other sections of the Act provide no new insight to the examination of the accounts or to a 'true and correct' balance sheet. The relevant minor section to bring in is s19(1) which states that *"Every auditor...shall be entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of the duties of the auditors"*. It only seeks to support the literal conclusion given earlier on category (r₄) that the fraud detection duty is partly restricted by the information and explanations given to the auditor.

In view of the fact that there is no added contextual insight to be gained here, the contextual meaning remains at the literal level of 1b(r₄) above.

6.9.3 PURPOSIVE INTERPRETATIONS

It seems that the audit now seeks to protect the creditors too in the area of disclosure and valuation. Lord Faber in the House of Lords (Session 14 March 1907) said,

"The Bill proposes to enlarge the requirements of the Companies Act, 1900. We on the (House of Lords) Committee thought that a man who was applying for shares in a limited company should know everything that it was material for him to know, otherwise he would be unable to form a true and accurate judgement of the company and its standing...It's chief objects are to protect shareholders in limited companies and those traders who trade with limited companies."

(col 170-1)

The company audit it appears, is mainly to protect shareholders and creditors in order for the prospective investor 'to form a true and accurate judgement'. It seems to imply that the audited accounts and balance sheet should be true and accurate. Further evidence for the detection of fraud could be obtained in the House of Lords (Session 2 May 1907) when Lord Avebury proposed that one at least of the auditors, in the case of every company whose authorised capital amounted to £50,000 should be a professional accountant.

"This provision was necessary because auditors not specially trained in accounts sometimes overlooked matters that ought to be brought to light. The auditing of accounts was a very technical, (one) might almost say scientific business, and it was extremely in the interests of the shareholder that one at least of the auditors in all important companies should have had professional training...to that duty. He had known several cases where otherwise excellent auditors had, through not having special training overlooked frauds which a professional accountant would at once have detected."

(col 1004-5)

The *"matters that ought to be brought to light"* refers to fraud which the House of Lords stated explicitly the duty of auditors to detect, for which a professional accountant would have received training.

In paragraph 44 of the Warmington Committee Report (1906), the Committee made some minor amendments to the wording of the auditor's duties under s23 of the previous Companies Act 1900.

"We...consider that the words, 'they have obtained all the information they have required' should be substituted for the words, 'all their requirements as auditors have

been complied with'. And after the words, 'correct view of the state of the company's affairs' the words 'according to the best of their information and the explanations given to them and' should be inserted."

The precise rationale for the amendments here were not given in the Report, though one can only refer back to the earlier explicit general guiding principles of reform established by the Committee that it was 'to repress fraud'.

The House of Lords stated explicitly in the statutory audit (ie level 1) that professionally trained auditors would at once have detected fraud which ought to be brought to light in the interests of the shareholder (ie level a). Hence, it appears that the auditor still has an explicit statutory duty to detect fraud, but restricted to the books and information/explanations given (ie category (r₄)). Thus, level 1a(r₄).

6.9.4 SUMMARY

	LEVEL
Literal Interpretation	1b(r ₄)
Contextual Interpretation	1b(r ₄)
Purposive Interpretation	1a(r ₄)

6.10 COMPANIES (CONSOLIDATION) ACT 1908

6.10.1 LITERAL INTERPRETATION

As can be seen from the wording of s113(2), it is exactly identical to s19(2) of the Companies Act 1907. The Act itself does not clarify the terms used on the auditor's duties (per s285, Interpretation Section) and the level reached in the previous Companies Act of 1907 also applies here.

Hence the conclusion remains the same at level 1b(r₄).

6.10.2 CONTEXTUAL INTERPRETATION

Table A cl 103 states that

"The directors shall cause true accounts to be kept:

- *of the sums of money received and expended by the company and the matter in respect of which such receipt and expenditure takes place, and*
- *of the assets and liabilities of the company."*

Hence, with the context of cl 103, it clarifies that the auditors in 'examining' the accounts should ensure that 'true' accounts are kept by the directors.

Section 113(1) of this Act relates to s19(1) of the Companies Act 1907. Being an identical Act, the points that one would cover here are similar to that covered in the contextual section of the Companies Act 1907 with no new purposive insight. The conclusion reached would be identical, ie level 1b(r₄).

6.10.3 PURPOSIVE INTERPRETATION

The discussions in both Houses of Parliament were very brief and centred on making the Bill not in any sense an amending Bill but purely a consolidation Bill; to consolidate various Acts dealing with company law with one object to reproduce the existing law in a compendious and convenient form.

In view of it being a consolidation Act and the wording of s113(2) being identical with s19(2) of the Companies Act 1907 with no new purposive insight, the conclusion reached there still applies here, ie level 1a(r₄).

6.10.4 JUDICIAL INTERPRETATION

6.10.4.1 *CUFF v LONDON AND COUNTY LAND AND BUILDING CO LTD (1912) 1 Ch 440*

This case concerns the auditor's statutory right of inspection of books rather than on a duty to detect fraud. But there were some relevant extracts, which may have some persuasive authority.

6.10.4.1.1 COUNSEL'S (FOR THE DEFENDANT) INTERPRETATION

Counsel made an inference without referring to the Act that the common law audit (ie level 2) should be for the purpose of discovering anything in the books [ie category (r₅)]

which would be in the interests or for the protection of the shareholders in the company (1 Ch 445).

The Shorter Oxford Dictionary defines 'protection' as: Defence from harm, danger or evil (c 1350-1450). It seems that counsel's view in expecting the auditor to defend the shareholders from harm or evil implies a duty to detect fraud in the books (ie level b). Hence, level 2b(r₅).

6.10.4.1.2 COUNSEL'S (FOR THE AUDITOR) INTERPRETATION

Here counsel said,

"The plaintiffs have statutory duties to perform under s113 of the Companies (Consolidation) Act 1908. They are responsible for the performance of those duties, not only to the shareholders but also to the creditors of the company...(Their) duties are fixed by statute, with a view to their acting as a check upon the directors and protecting the shareholders and the public."

(1 Ch 446)

The Shorter Oxford Dictionary defines 'CHECK' as:

- (1706) A counterfoil or other means to secure accuracy, security from fraud
- (1786) Control by which accuracy is secured.

It appears that by using the words 'check' and 'protecting', counsel implies that the auditor has a statutory duty to detect fraud for the benefit of the shareholders and the public, hence level 1b.

6.10.4.1.3 HIGH COURT JUDGE'S INTERPRETATION

The Court of Appeal did not raise the issue of the auditor's statutory duties as they dealt with the right of inspection of books. But at the first instance hearing in the High Court, Eve J said as obiter dicta [ie category (o)] that

"Mere compliance with the letter of these statutory requirements [s113(2)] involves a comparison of the entries in the book with the figures in the balance sheet, but no one would suggest that the duty of the auditor is limited to ascertaining that the entries in the books of the company are correctly transcribed or summarised in the balance sheet. As has been pointed out...he is bound to inquire, and to take trouble to ascertain

whether the books themselves show the company's true position, and such investigation must of necessity range over an area which covers accounts, vouchers, invoices, and documents, constituting the materials out of which the entries in the books originate."

(1 Ch 444)

The Shorter Oxford Dictionary defines the following words:

INQUIRE (1787) : to search into, seek knowledge concerning, investigate, examine

ASCERTAIN (1794) : To find out or learn for a certainty, to make sure of, get to know

The judge appears to interpret the statutory source s113(2) (ie level 1) as not just matching up the balance sheet with the accounts but also to inquire, to take trouble, to search into the books and ensure that the company's true position as evidenced in the books is backed up by supporting documentation (accounts, vouchers, invoices and documents). It implies (ie level b) a duty to detect fraud in order to meet those requirements. The auditor it seems, has a statutory duty to detect fraud here but only restricted to the books and by supporting documentation [ie category (r₃)]. Hence level 1b(r₃) obiter.

6.10.4.2 RE CITY EQUITABLE FIRE INSURANCE CO LTD (1925) 1 Ch 407

6.10.4.2.1 COUNSEL'S (FOR THE APPELLANT) INTERPRETATION

Counsel said:

"The duty of an auditor as stated by Lindley L J in re London and General Bank is to 'check the cash, examine vouchers for payments, see that the bills and securities entered in the books were held by the bank and take reasonable care to ascertain their value'. The auditors in this case have fallen far short of that standard."

(1 Ch 417)

Whether 'that standard' involves fraud detection was not elaborated expressly by counsel except that it involves some 'checking, 'examining', 'seeing' and 'taking reasonable care to ascertain their value'. Such language do imply some degree towards detecting fraud (ie level b). The basis of that duty was determined by counsel, not

from statute law but from the case law of *London and General Bank* (ie level 2). Hence level 2b.

6.10.4.2.2 COUNSEL'S (FOR THE AUDITOR) INTERPRETATION

Here counsel argued that

"There has, we submit been no wilful neglect or default on the part of Mr Lepine (auditor)...The principles relating to an auditor's duty are clearly laid down in re London and General Bank and in re Kingston Cotton Mill Co and are applicable to the present case, and if applied to the facts of this case, absolve the respondent auditors from all liability."

(1 Ch 422-3)

Here counsel claims that the auditor has not defaulted in his duty. What that duty was, was not elaborated at all. Reference to the auditor's duties were made to case law and not statute law, claiming that it is 'clearly laid down' there. Counsel has been rather vague here. As they assert that the auditor is not liable for failure to detect the fraud in the normal audit, it is possible by implication (ie level b) for counsel to believe that the auditor has judicially no duty to detect fraud but up to the parties in privity (ie level 4), hence level 4b.

6.10.4.2.3 JUDGE'S INTERPRETATION

This case first reached the Chancery Division and was presided by Mr Justice Romer. Subsequently when the case went up to the Court of Appeal, all the three judges (Pollock M R, Warrington and Sargant L J J) concurred in affirming as a whole the decision of Romer J.

First of all, the judges commented that s113 does not lay down a rigid or clear cut code. The statutory duty imposed on the auditors is not absolute, but depends upon the information given and explanations furnished to them, so that there is abundant scope for discretion. Auditors would still be expected to comply with the vague statutory provisions, to be determined by the general rules of ordinary law or a special contractual engagement, defining the duties of the auditor. This was expressed as follows:

"Section 113 does not lay down any rule at all as to the amount of care or skill, or investigation, or anything of that kind, which is to be brought to bear by the auditors in

performing the duties which are imposed upon them...It (s113) says nothing as to what they (auditors) are to do in order to form that opinion, or to ascertain the truth of the facts to which they are to certify. That is left to be determined by the general rules which, in point of law, are held to govern the duties of the auditors, whether those rules are to be derived from the ordinary law, or from the terms under which the auditors are to be employed."

(Warmington L J, 1 Ch 525)

"Once you have any duty to be performed according to the information given, and explanations offered, you obviously have introduced matters in which discretion is to have play..."

(Pollock M R, 1 Ch 515)

"As to what the (statutory) duty is, there is not much authority to be found in the books. But in re London and General Bank, Lindley L J dealt at some length with the duties of the auditor of a company...I am convinced that throughout the audits that he (auditor) conducted, he honestly and carefully discharged what he conceived to be the whole of his duty to the company. If in certain matters he fell short of his real duty, it was because in all good faith, he held a mistaken belief as to what that duty was."

(Romer J, 1 Ch 498-9)

It appears that in view of the difficulty in interpreting s113, auditors themselves have offered their own conception of what that duty is, which may be 'a mistaken belief' to that statutory duty when judicially considered.

"What is the standard of duty which is to be applied to the auditors? That is to be found in...re Kingston Cotton Mill Co...But it has been well said that an auditor is not bound to be a detective or to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch-dog, but not a bloodhound. That metaphor was used by Lopes L J in re Kingston Cotton Mill Co. Perhaps casting metaphor aside, the position is more happily exposed in the phrase used by my brother Sargant L J, who said the duty of an auditor is verification and not detection...and the fact that Mr Lepine (auditor) was unsuccessful in detecting the cunning is quite another matter from saying that he failed to use competence and intelligence in conducting his duties."

(Pollock M R, 1 Ch 509, 520)

Lord Justice Warrington also reinforced the shift from fraud detection to the verification of financial accounting records' accuracy when he said:

"The duty of the auditor is to verify the facts which it is proposed to state in the balance sheet, and in doing so to use reasonable and ordinary skill. I need say no more about the general duties of an auditor."

(1 Ch 520)

In view of this shift in the judicial interpretation of the statutory duty, the auditors were not found guilty of negligence in not discovering the fraud on the matter of window dressing from his inspection of the company's books.

What should also be worth pointing out is that when Lord Justice Warrington mentioned earlier that the 'general rules' are 'to be derived from the ordinary law', Pollock M R seems to infer that the ordinary law is derived from business rules and common sense as follows.

*"But that does not discharge him (auditor) from having put aside what I described...as the rule of the road applied with the proviso as to business rules and common sense."
(1 Ch 515)*

As the Appeal Court has stated expressly that the auditor has no duty to detect fraud but only verification, the duty to detect fraud falls by implication (ie level b) on the terms of an arranged contract to detect fraud (ie level 4), hence level 4b.

6.10.5 SUMMARY

	LEVEL
Literal Interpretation	1b(r ₄)
Contextual Interpretation	1b(r ₄)
Purposive Interpretation	1a(r ₄)
1925 Judicial Interpretation	4b [Counsel for auditor's interpretation] 2b [Counsel for appellants' interpretation]
1912 Judicial Interpretation	1b(r ₃)(o) 1b [Counsel for auditor's interpretation] 2b(r ₅) [Counsel for defendant's interpretation]

6.11 COMPANIES ACT 1929

6.11.1 LITERAL INTERPRETATION

As can be seen from the wording of s134(1), it is taken from s113(2) of the Companies (Consolidation Act) 1908. The Definition Section (s380) provided no assistance to the wording. The Act itself did not expand on the auditor's duties here and hence the conclusion reached for 1908 remains, ie level 1b(r₄).

6.11.2 CONTEXTUAL INTERPRETATION

There are no contextual insights to be gained from this consolidating Act. The conclusion reached for the previous Companies (Consolidation) Act 1908 and the literal level above remains unchanged for this interpretation section. Hence level 1b(r₄).

6.11.3 PURPOSIVE INTERPRETATION

This Bill was passed through very quickly in the Parliament, being purely a consolidation Bill, to consolidate the Act passed in the previous year and all the preceding Companies Acts. It passed through a Joint Committee of both Houses who had been merely concerned with the technicalities of consolidation.

In the absence of information to the contrary, the conclusion reached in 1908 still remains, ie level 1a(r₄).

6.11.4 SUMMARY

	LEVEL
Literal Interpretation	1b(r ₄)
Contextual Interpretation	1b(r ₄)
Purposive Interpretation	1a(r ₄)

6.12 COMPANIES ACT 1947

This Act has extended the auditor's duties to the types and content of the financial statements. Auditors have now to report on the profit and loss account as well as the group accounts, in addition to the balance sheet and the accounts [s22(1)(a)].

6.12.1 LITERAL INTERPRETATION

Under s22(1)(b), the auditor's report has been modified by the Second Schedule and penalises auditors for wilfully making a false audit report (s362 Companies Act 1929).

The second schedule requires the auditor to report expressly whether:-

- i) all necessary information and explanations were obtained *"to the best of their knowledge and belief"*.

It appears to excuse the honest auditor for failure to detect 'fraudulent' information and explanations if their 'best' knowledge and belief showed otherwise.

- ii) 'proper' books have been kept based on their examination and adequate 'proper' returns received from branches not visited by them.

The Shorter Oxford Dictionary defines PROPER (1449) as accurate, exact, correct.

It thus seems that the books and returns need to be accurate and correct, ie not misleading 'so far as appears from their examination'. It is not phrased in absolute explicit terms, hence even if a fraud detection duty is expected here, it is an implied or limited duty.

- iii)
 - a) The company's balance sheet and (consolidated) profit and loss account are in agreement with the accounts and returns, (ie a correct transcribe), and
 - b) in their opinion and to the best of their knowledge (based on information and explanations given) the profit and loss account and balance sheet including group accounts disclose the information required and show a true and fair view.

Part III of the First Schedule allows banking, discount and assurance companies exempt from certain disclosure requirements.

The Shorter Oxford Dictionary's meaning of the words 'true and fair' [see s6.5.2] implies that the financial statements are supported with documentation or facts and is free from fraud.

The information required in the principal Act of 1929 (s122-129) and this Act (s13-18) mainly deals with guidance on recording (eg cash-book and investments), classification of information (eg emoluments and fixed vs current assets), disclosure requirements on the contents (eg balance sheet and group accounts) and accounting policies (eg on fixed assets and foreign currency translations). This Act stipulates that material amounts are applicable under these requirements. As auditors are still required to report on 'a true and fair' view, it seems to imply the absence of material fraud.

It should be noted that s123 (Construction of Terms) and Part 4 of the First Schedule which offers interpretation of that Schedule offers no assistance in this area. The Interpretation Acts also are of no assistance here.

Based on the literal interpretation above of the requirements for 'true and fair' and 'proper', it seems that the auditor has some duty to detect fraud (ie level b). Nevertheless, the statutory duty (ie level 1) is not an absolute one. As the Act specifically (1st Schedule, Part I) is not concerned with disclosure of immaterial amounts, it would further refine that duty to material fraud [ie category (r₂)]. Hence level 1b(r₂).

6.12.2 CONTEXTUAL INTERPRETATION

The only other contextual section to add in is s12(1) which amplifies the meaning of 'proper books of account':-

"For the purposes of subsection(1) of section one hundred and twenty-two of the principal Act (which imposes on a company to keep books of account), proper books of account shall not be deemed to be kept with respect to the matters specified in that subsection, if there are not kept such books of account as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions."

Hence the word 'proper' is reinterpreted here to be that level which gives a true and fair view and the transactions explainable (ie adequate recordings). Such further contextual insight provides no different conclusion from the one offered literally. Rather it reinforces it since the term 'true and fair' has connotations with absence of material fraud. Hence level 1b(r₂).

6.12.3 PURPOSIVE INTERPRETATION

So what is the purpose of the statutory audit? Both Houses seem to conclude that it is there to offer some protection to the shareholders and the public. When s22 and the Second Schedule were passed through the Committees of both Houses, it was agreed to without any discussion. But some insight can be gleaned from Sir Stafford Cripps when in the House of Commons (Session 6 June 1947), he first quoted paragraph 7(c) of the Cohen Report (1945) and proceeded to expand on the purpose of the audit.

"(The illusory nature of the control theoretically exercised by shareholders over directors has been accentuated by the dispersal of capital among an increasing number of small shareholders who pay little attention to their investments so long as satisfactory dividends are forthcoming; who lack sufficient time, money and experience to make full use of their rights as occasion arises and who are, in many cases, too numerous and too widely dispersed to be able to organise themselves)

That is a problem which the Committee had to face. The individual shareholders may not, of course, always appreciate the significance of the facts which are submitted to them, but if the facts are presented fully and accurately [note the order], then the informed opinion of experts, such as accountants (or auditors)...will be available in order to make public criticism and this applies,...specially to the accounts of companies"

(col 587-8)

It appears that fraud detection for the auditor has been relegated to a secondary objective. In view of the massive increase in the quantity and quality of financial information being supplied to the shareholder, it seems that the major audit objective is to give an expert opinion on the compliance of full disclosure in the manner required statutorily and secondly, the verification of the reliability or accuracy of the accounting data on which the disclosed information had been based. Fraud detection is probably placed as a secondary objective [ie category (s)] of the statutory (ie level 1) audit, but implied (ie level b) because of their possible effect on the reliability of the accounting data and its effect on a true and fair view. Hence level 1b(s).

6.12.4 SUMMARY

	LEVEL
Literal Interpretation	1b(r ₂)
Contextual Interpretation	1b(r ₂)
Purposive Interpretation	1b(s)

6.13 COMPANIES ACT 1948

6.13.1 LITERAL INTERPRETATION

The Interpretation Section (s455) of the Act offers no assistance here.

The wording of s162(1) is similar to s22(1) of the Companies Act 1947. The Ninth Schedule is identical to the Second Schedule of the previous Companies Act. Hence, the literal conclusion remains the same for the Companies Act 1947 ie level 1b(r₂).

6.13.2 CONTEXTUAL INTERPRETATION

In spite of its length of some 462 clauses and 18 schedules, this consolidation Act did not provide anything contextually at all which is new to clarify the understanding of the auditor's duties. The meaning of 'proper books of account' is now under s147(2). Hence the conclusion remains as for above and the Companies Act 1947, ie level 1b(r₂).

6.13.3 PURPOSIVE INTERPRETATION

The Cohen Committee of 1945 reported that if the amending Act of 1947 was passed by Parliament, it should be followed immediately by a consolidating Act. The rationale laid down was that constant reference had to be made to the Companies Acts by businessmen and the advantage of having all the statute law embodied in a consolidating Act which can easily be referred to without the necessity for cross-reference.

There was very little debate in both Houses. The view point expressed by both Houses in the Companies Act 1947 still holds. Hence level 1b(s).

6.13.4 JUDICIAL INTERPRETATION OF *RE THOMAS GERRARD AND SON LTD* (1967) 2 ALL ER 525

6.13.4.1 COUNSEL'S INTERPRETATION

Counsel's argument for either the respondents or the appellants were not recorded in the Law Reports. Hence it is not available for comment.

6.13.4.2 HIGH COURT JUDGE'S INTERPRETATION

Pennyquick J in giving judgement referred to the *London and General Bank (1895)* case and the *Kingston Cotton Mill (1896)* case. Below are some of the relevant extracts in the judge's attempt to interpret and apply s162(1) and the Ninth Schedule.

"The scheme of the Act of 1948 is that...the auditors must...exercise reasonable care and skill. Equally if he performs these mental operations without exercising reasonable care and skill and then proceeds to give an unqualified statement,...he is in breach of his statutory duty as an officer of the company. ...It has always been the law that an auditor must exercise reasonable care and skill and it could hardly be suggested that the effect of the present statutory provisions is to diminish this obligation."

(2 ALL ER 534)

"...the quality of the auditor's duty has [not] changed in any relevant respect since 1896. Basically that duty has always been to audit the company's accounts with reasonable care and skill...[which are] more exacting today than those...in 1896...[It would] be very chary indeed of reaching a conclusion different from that reached by the Court of Appeal in Re Kingston Cotton Mill Co."

I will assume in their favour that Mr Nightingale [auditor] was entitled to rely on the assurances...until he first came on the altered invoices, but once these were discovered, he was clearly put on inquiry and I do not think that he was then entitled to rest content...as a matter of business common sense..., he ought to have...examined the suppliers' statements and where necessary have communicated with the suppliers."

He should in each subsequent audit have made such checks and such inquiries as would have ensured that any mis-attribution in the cut-off procedure was detected. He did not take any of these steps. I am bound to conclude that he failed in his duty. It is important in this connection to remember that this is not a case of some isolated failure in detection. The fraud was repeated half-yearly on a large scale for many years....Here suspicion ought emphatically to have been aroused and the auditors ought to have taken the steps which I have indicated."

The three heads are closely interrelated and once put on their guard under any one head, the auditors ought to have taken such steps as would have ensured that a fraud under either of the other heads equally would not remain undetected."

(2 ALL ER 536-37)

The last sentence states explicitly that when put on guard, fraud should not remain undetected (ie level a). Hence, it was held that to rely on the apparent moral and

commercial honesty of company management regarding the reliability of accounting data was not a sufficient audit check on the figures concerned. The ratio decidendi laid down here was that a statutory (ie level 1) auditor had a duty to detect fraud (with reasonable care and skill), especially if suspicion was or ought to have been aroused [ie category (r₁)]. Hence level 1a(r₁).

6.13.5 CONCLUSION

	LEVEL
Literal Interpretation	1b(r ₂)
Contextual Interpretation	1b(r ₂)
Purposive Interpretation	1b(s)
Judicial Interpretation	1a(r ₁)

6.14 COMPANIES ACT 1967

6.14.1 LITERAL INTERPRETATION

The wording of s14(1) is similar to s162(1) of the Companies Act 1948.

Section 14(3) requires the auditor to report on whether the financial statements (balance sheet, profit and loss account, group accounts):

- (a) have been properly prepared in accordance with the statutory accounting and disclosure requirements; and
- (b) give a true and fair view.

But what does 'true and fair' mean?

The Interpretation Acts of 1850, 1889 and 1978, nor the Interpretation Section of this Act, provided any assistance in this area. The Shorter Oxford Dictionary defines:

TRUE (c1150-1350) : Consistent with fact; agreeing with reality, representing the thing as it is

FAIR (c1150-1350) : Free from bias, fraud or injustice; equitable, legitimate

Applying the literal dictionary meaning, 'true and fair' seems to imply that the financial statements need to be representative of reality and free from fraud (ie level b). It should be noticed that in contrast with the earlier principal Act of 1948, s14(3)(a) in the auditor's opinion is not constrained by the best of the information and explanations given to the auditors. On deciding on whether proper books of account have been kept [s14(4)(a)], that has also been relaxed, without the proviso of "*so far as appears from their examination of those books*". Also since the principal Act (1st Schedule, Part I CA 1948) is only concerned with the disclosure of material amounts, it would seem reasonable to restrict the statutory (ie level 1) duty to material fraud [ie category (r₂)]. Hence, level 1b(r₂).

6.14.2 CONTEXTUAL INTERPRETATION

There are no other relevant contextual provisions to add here. The conclusion reached will be the same as for the above literal interpretation, ie level 1b(r₂).

6.14.3 PURPOSIVE INTERPRETATION

This Act was drawn up as a result of the recommendations of the Jenkins Committee. It required greater disclosure of information in the accounts of companies and in the report of the directors of companies including disclosure about remuneration of directors, political contributions, charitable contributions and export trade.

But what was the specific purpose of requiring greater disclosure of information in company accounts?

In the House of Lords, Lord Byers said:

"I believe that greater disclosure of information is long overdue, because it will or should enable earlier detection of unsound or fraudulent company management, and furthermore, would give a greater safeguard for consumers who suffer when a company goes into liquidation...The additional information on public record will...have a self-regulatory effect on unsound company management."

(Session 22 November 1966 col 163-4)

In the House of Commons, the Minister of State and Board of Trade, Mr George Darling said:

"This Bill deals with the first stage and we think, the most urgent need - the need for the disclosure of far more information in company accounts and directors' report than is now required. There seems to be a widespread demand that companies should give a great deal more information about their affairs both to their shareholders and to the public.

We hold the view...that publicity in this field of business activities is perhaps the most important safeguard against abuse. But disclosure of information is desirable not only in the interests of creditors and investors and prospective investors; it is equally desirable and necessary in the interests of employees and in the interests of Government...

The 1948 Act of course, already requires a great deal of information to be given, but as honorary Members know, there has been a growing criticism of this part of the 1948 Act. It does not demand enough information. Investors have often been misled about the true state of affairs of companies whose shares they have bought or have intended to buy."

(Session 21 February 1966 col 35-7)

Though the dominant view towards increasing disclosure was seen in both Houses as a combat against fraud by management, there were others in minority, in the House of Commons [Mr Barber and Mr Bruce-Gardyne (Session 14 February 1967 col 375, 447)] who relegated it to a secondary function and saw the primary purpose to improve industrial and economic efficiency

Nevertheless increasing disclosure is being recognised as the predominant safeguard against fraud and not the audit. The Jenkin's Committee may have viewed the audit as not fraud-proof when they commented:

"No company's affairs can be managed properly, or indeed managed at all, otherwise than through a board of directors with a reasonably free hand to do what they think best in the interests of the company. The risk (which must not be exaggerated) that dishonest directors may abuse the trust reposed in them must be accepted [in spite of the audit] if business is to go on."

(The Jenkins Report 1962, para 14)

If the audit is not primarily to detect fraud, what is it there for? Section 14(3) of the Act requires the auditor to report expressly if the financial statements have been properly prepared in accordance with the statutory disclosure provisions and whether a true and fair view is given. On the issue of verifying compliance with the minimum

disclosure provisions, that is a fairly technical task. But on verifying if the financial statements are 'true and fair' requires some clarification.

In fact, some clarification was provided by the Jenkins Report (1962):

"In our view, the general scheme of the (1948) Act in this respect [ie to disclose the detailed information specified and to give a true and fair view] is the right one, namely to indicate in general terms the objectives [true and fair] and the standard of disclosure required [in the balance sheet and profit and loss account] and also to prescribe certain specific information [notes] that must be given. The formula 'true and fair' seems to us satisfactory as an indication of the required standard [of disclosure], while it makes for certainty to prescribe certain specific information which the law regards as the minimum necessary for the purpose of attaining that standard.

It seems to be generally understood that the accounts may not lawfully omit any of the information specified in the Eighth Schedule, without the authority of the Board of Trade: but we doubt if it is always appreciated that accounts which comply strictly with the requirements of the Eighth Schedule (and of sections 196 and 197) may still fail to give the true and fair view required by the Act, although we think this is the effect of s149(3) which provides that the duty to give the detailed information required by the Eighth Schedule is without prejudice to the general duty to give a true and fair view. "
(para 332)

"In fact it is contended, accounts that do not disclose these matters may present a view that is neither true nor fair. "

(para 433)

What the Jenkins Committee are saying here is that the accounts are true and fair if the required standard of minimum statutory disclosure is adhered to. This explains why the auditor is not required to report on a true and fair view under s14(3)(b) for banking, insurance or other companies which under Part III of the Eighth Schedule are exempted from disclosing certain information essential to the presentation of a true and fair view. It recognises the point that the disclosure exceptions in such companies may not lead to a true and fair view.

Such an attempted interpretation of the term 'true and fair' may have its roots in the Minutes of Evidence supplied by Sir Thomas Robson (on behalf of the Institute of Chartered Accountants in England and Wales) when he said:-

"A true and fair view implies an appropriate classification and grouping of the items and therefore the balance sheet needs to show in summary form the amounts of the share capital, reserves and liabilities as on the balance sheet date and the amounts of the assets representing them, together with sufficient information to indicate the general nature of the items. "

(The Jenkins Report 1962, p1355)

The Jenkins Committee also attempted to interpret s149(3) Companies Act 1948 which has been drafted so badly and vaguely that it is difficult to decipher it literally. Nevertheless, the Jenkins Committee expressed the view that rigid compliance with the disclosure requirements may not give a true and fair view whereas it is possible to depart from the disclosure requirements and yet give a true and fair view. The meaning of true and fair is much broader than blind compliance with the disclosure requirements. It is possible for financial statements to disclose all the statutory requirements and yet remain fraudulent.

Whilst the Jenkins Committee has made an indelible step in interpreting the phrase 'true and fair', it also realises that there is some danger of the public misunderstanding the use of the phrase as they would be inclined to take the phrase at their face value or literal meaning (see Minutes of Evidence, The Jenkins Report 1962, p1356).

In fact Mr Bruce-Gardyne may have summed up the purpose of the audit quite well when he said:

"All company legislation (incorporating the audit) should essentially have two objectives. First, it should be designed to encourage the efficient use of capital and to provide the shareholder with information to judge where his capital is most likely to be most efficiently used. Secondly, it should be designed to protect the shareholder from oppression or fraud by management."

(House of Commons, Session 21 February 1966 col 115)

The increased disclosure was seen as the most important safeguard against fraud. The primary purpose of the statutory (ie level 1) audit is to verify the minimum statutory disclosure requirements as prima facie evidence of true and fair. Fraud detection thus adopts a secondary role [ie category (s)], by implication, due to the overriding general duty to give a true and fair view beyond the technical disclosure requirements and protecting the shareholder from fraud. It was shown in s6.12.2 that the general requirement of 'true and fair' implies that the financial statements are supported with documentation or facts and is free from fraud (ie level b). Hence level 1b(s).

6.14.4 SUMMARY

	LEVEL
Literal Interpretation	1b(r₂)
Contextual Interpretation	1b(r₂)
Purposive Interpretation	1b(s)

6.15 COMPANIES ACT 1981

6.15.1 LITERAL INTERPRETATION

In this Act, the added responsibility on the auditor lies in the area of the directors' report. Prior to the 1981 Act, the directors' report was not required to be the subject of the auditor's attention. However, this Act (s15) extended his review of the annual financial report to include a consideration of this statement, and specifically to report when relevant, that the information contained in it was inconsistent with the main audited financial statements.

So the auditor had to 'consider' for 'consistency' in the directors' report. But, what do the key words mean? The Interpretation Sections of the Act (s21 and s118) nor the Interpretation Acts offer any insight.

One then resorts to the Shorter Oxford Dictionary for some clarification:

CONSIDER (c1150-1350) : To look attentively, to survey, examine, inspect

CONSISTENT (1646) : Agreeing or according in substance or form, congruous, compatible

Thus, it seems that the auditor had to look attentively into the directors' report to ensure the contents agree in substance with the main audited financial statements, ie not misleading. This implies a responsibility to ensure that the directors' report is not fraudulently reported (ie level b). Such a conclusion here would only strengthen the literal conclusion reached in the principal Act of 1967, namely an implied duty to detect material fraud, ie level 1b(r₂). Hence it remains at this level.

6.15.2 CONTEXTUAL INTERPRETATION

Under s13 and 14 of the Act, directors are required to give in their report a fair review of the development and position of the company, and information on important events since the balance sheet date, likely future developments and on research and development activities. In requiring the auditors to check for consistency, it is possible that auditors had now to examine beyond the limits of a particular financial year and take account of possible future events in determining the 'truth and fairness' of the main financial statements. If that is the case, the auditor was thus being asked to enter an area of greater uncertainty than he may hitherto have been accustomed.

As regards the meaning of 'true and fair', the 1981 Act seeks to clarify it explicitly for the first time under s1(1). The essence of that section is also manifested in s2 for group accounts.

s1-

"Section 149 of 1948 Act shall be renumbered section 149A and the following section shall be inserted in that Act as section 149-

- 149 -
- (1) *The accounts of a company prepared under s1 of the Companies Act 1976 shall comply with the requirements of Schedule 8 to this Act (so far as applicable) with respect to the form and content of the balance sheet and profit and loss account and any additional information to be provided by way of notes to the accounts.*
 - (2) *Every balance sheet of a company so prepared shall give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account of a company so prepared shall give a true and fair view of the profit or loss of the company for the financial year.*
 - (3) *Subsection (2) above overrides the requirements of Schedule 8 to this Act and all other requirements of the Companies Act 1948 to 1981 as to the matters to be included in a company's accounts or in notes to those accounts, and accordingly -*
 - (a) *if a balance sheet or profit and loss account of a company drawn up in accordance with those requirements would not provide sufficient information to comply with that subsection, any necessary additional information must be provided in that balance sheet or profit and loss account or in a note to the accounts; and*
 - (b) *if, owing to special circumstances in the case of any company, compliance with any such requirement in relation to any balance sheet or profit and loss account*

of the company would prevent that balance sheet or profit and loss account from complying with that subsection [even if additional information were provided in accordance with paragraph (a) above] the directors of that company shall depart from that requirement in preparing that balance sheet or profit and loss account (so far as necessary in order to comply with that subsection)."

Hence, s149(2) seems to be saying that 'true and fair' means complying with the disclosure requirements (form content, notes) of the Companies Acts. Such a contextual interpretation generated by linking it to s1(1) has offered a different meaning to one interpreted literally.

There is also a 'true and fair override' provision under s149(3) which requires directors to provide extra information or detract from the disclosure requirements so as to give a true and fair view.

So where does the auditor stand as regards fraud detection, if the major audit objective of 'true and fair' has now shifted to giving an opinion on the compliance with the minimum statutory disclosure requirements? Fraud detection could be a secondary function, but there is insufficient contextual evidence to support that conclusion. Hence, it is relegated by implication (ie level b) to level 4, to be arranged between the parties in privity. The level becomes 4b.

6.15.3 PURPOSIVE INTERPRETATION

This Act owes its existence in the first instance largely to the need to fulfil the United Kingdom's obligations to implement a European Community company law directive - the Fourth Directive. The EEC Council of Ministers adopted the Fourth Directive on Company Law on 25 July 1978. The intention of the Directive is the harmonisation of the content, presentation and publication of the annual accounts of limited companies and of the valuation methods used in preparing those accounts. Member states were required to incorporate the provisions of the Directive into their national law by July 1980. As a result a consultative document *Company Accounting and Disclosure* was drawn up (DTI, 1979) to implement the provisions. It thus reflects the fact that to some extent the agenda of company law reform and change in this country is being shaped by the various proposals for the harmonisation of company law in the Community.

The Council of the European Communities reported on the Fourth Council Directive (1978) that

"...annual accounts must give a true and fair view of a company's assets and liabilities, financial position and profit or loss;...to this end a mandatory layout must be prescribed for the balance sheet and the profit and loss account and...the minimum content of the notes on the accounts and the annual report must be laid down;...however, derogations may be granted for certain companies of minor economic or social importance."

(para 8)

Article 2(3) of the Fourth Directive subsequently provided that the annual accounts of a company shall give 'a true and fair view of the company's assets, liabilities, financial position and profit or loss'. This is achieved if the annual accounts are drawn up clearly and in accordance with the provisions (format, content, valuation rules, notes) of this Directive [Article 2(2)]. Article 2(4) provides that information must be added in order to give a true and fair view if compliance with the provisions of the Directive would not be sufficient for this. Article 2(5) provides that in the exceptional case where compliance with the provisions of the Directive would not give a true and fair view, the provisions must be departed from in order to give a true and fair view and a full explanation given in the notes to the accounts. The annual accounts are defined in Article 2(1) as the balance sheet, the profit and loss account and the notes to the accounts.

The United Kingdom's success in incorporating the concept of true and fair into the Fourth Directive has had the important consequence of making this concept a part of European law (Lasok and Grace, 1989). As a result of the implementation of the Fourth Directive, the concept is now enshrined in the laws of all the other Member States. As noted by McGee (1991), one objection to the view that the requirement is a legal one comes from the fact that the inclusion of the true and fair view requirement was sought by the United Kingdom as a reaction against the very detailed rules contained in the Fourth Directive.

The Fourth Directive permits the statutory audit of the annual accounts of small companies to be abolished. The arguments for its retention will provide some insight into the auditor's duty to detect fraud.

In the House of Lords, Lord Trefgarne said:

"Views on this possibility were divided, but the weight of the comments sent to the Government was that continued audit was necessary for the protection of shareholders and creditors (who are often indeed small companies themselves)."

(Session 26 February 1981 col 1164)

Viscount Caldecote endorsed the retention of the small company audit when he said:

"I am glad that the annual audit requirement for small companies will be retained, otherwise again this could lead to a difficult and misleading situation."

(House of Lords, Session 26 February 1981 col 1187)

In the House of Commons, Mr Squire said:

"Any certification by an independent auditor who is unqualified, or even by one who is qualified in a relatively minor way, is better than a statement by the directors of a company that its assets and liabilities are as certified by them. That would be unacceptable. Without wishing to cast any doubts on the honesty of most of those who run such companies, there are undoubtedly a number who are not so careful about the manner in which they conduct their affairs."

(Session 1 June 1981 col 675)

What seems to be emerging from both Houses is that whilst it is the primary duty of the auditor to verify the disclosure provisions, there is also the resistant view that the audit is there secondly (ie category (s)) to 'protect' the shareholders against 'misleading' situations by dishonest management or directors. The view of 'protection' against 'misleading situations' through the audit implies a duty towards fraud detection, (ie level b). Any independent audit in the context of management's honesty or dishonesty is better than no audit at all was the view held in the House of Commons. It appears that the statutory (ie level 1) auditor still has an implicit secondary duty to detect fraud, hence level 1b(s).

6.15.4 SUMMARY

	LEVEL
Literal Interpretation	1b(r ₂)
Contextual Interpretation	4b
Purposive Interpretation	1b(s)

6.16 COMPANIES ACT 1985

6.16.1 LITERAL INTERPRETATION

The Interpretation Section (Part 26) offers no assistance here dealing mainly with technical or drafting amendments. This Act is purely a consolidation of the earlier Companies Acts. Sections 236 and 237(1),(2),(4) has its roots in s14 of the Companies Act 1967 and s237(5) from s6-8 of Companies Act 1967 and s54-61 of Companies Act 1980 and finally s237(6) from s15 of the Companies Act 1981.

As this is only a consolidation Act, the literal duty here remains the same as for those Companies Acts ie level 1b(r₂).

6.16.2 CONTEXTUAL INTERPRETATION

Being only a consolidating Act with no contextual provisions added, the contextual interpretation will remain the same as for Companies Act 1981. Section 1(1) of the Companies Act 1981 is now embodied in s228 of the Companies Act 1985. Hence, the level remains at 4b.

6.16.3 PURPOSIVE INTERPRETATION

The main purpose of the consolidation is to put the greater part of legislation relating to companies in one Act and in a logical sequence. An attempt also has been made to modernise the English to make it more readable and more easily comprehended. However, the change in language does not, of itself, mean a change in the law. The Lord Chancellor, Lord Hailsham in the House of Lords (Session 20 November 1984) said:

"But since [the principal Act of] 1948, there have been five major company law statutes in 1967, in 1976, in 1980 and 1981 - together with a Scottish Act of 1972. Other primary legislation has affected company law, notably the European Communities Act 1972. There has also been a considerable volume of subordinate legislation. In the result, the relevant law has become more and more complicated. There is a need for another consolidation to pull things together and restate the law in a more convenient form. But this consolidation...[will] make a major contribution to the clarification and accountability of company law and will be of immediate benefit to the business community."

(col 494-5)

Being thus a consolidating Act, the Government's view established in the 1981 Act will still thus hold, ie the auditor has an implied secondary duty to detect fraud, ie level 1b(s).

6.16.4 JUDICIAL INTERPRETATION OF *CAPARO INDUSTRIES PLC v DICKMAN AND OTHERS (1990) 1 ALL ER 568*

6.16.4.1 COUNSEL'S INTERPRETATION

The case did not report on either counsel's argument. Hence it is not available for comment here.

6.16.4.2 HOUSE OF LORDS' INTERPRETATION

The ratio of the case dealt with the liability to third parties and to individual shareholders. Hence, the comments given to the statutory duties of auditors were given in its capacity as obiter dicta.

Lord Bridge said:

*"The position of auditors in relation to the shareholders of a public limited liability company arising from the relevant provisions of the Companies Act 1985 is accurately summarised in the judgement of Bingham L J in the Court of Appeal [(1989) 1 ALL ER 798 at 804]....But he is employed by the company to exercise his professional skill and judgement for the purpose of giving the shareholders an independent report on the reliability of the company's accounts and thus on their investment. Vaughan Williams J said in *Re Kingston Cotton Mill Co (1896) 1 Ch 6 at 11*: 'No doubt he is acting antagonistically to the directors in the sense that he is appointed by the shareholders to be a check upon them'. ...A negligent failure of the auditor to report accurately on the state of the company's finances deprives the shareholders of the opportunity to exercise their powers in general meeting to call the directors to book and to ensure that errors in management are corrected."*

(1 ALL ER 579-80)

Lord Oliver added:

"It is the auditors [statutory] function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order, first, to protect the company itself from the consequences of undetected errors, or possibly wrong doings (by, for instance, declaring dividends out of capital) and second, to provide shareholders with reliable intelligence for the

purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided."

(1 ALL ER 583)

It appears from the judicial interpretation of the statutory (ie level 1) audit that the auditor in checking the accuracy and thus the reliability of the financial statements and accounts have some duty to detect wrong doings or fraud. But that duty is not absolute but 'only so far as possible'. What does Lord Oliver mean there?

Perhaps the obiter dictum by Lord Justice Taylor in the earlier Court of Appeal *[(1989) 1 ALL ER 821]* may explain that further.

"A plaintiff shareholder...would first have to establish that the auditors were negligent. It would by no means follow, for example, that failure to expose deliberate and well concealed fraud on the part of a company's directors would amount to negligence by the auditors. They are not insurers. They would be judged by reasonable professional standards."

The duty 'to protect the company from the consequences of undetected wrong doings' appears to be fairly explicitly stated towards fraud detection (ie level a). But the obiter [ie category (o)] duty to detect fraud is qualified by a reasonableness test of professional care and skill [ie category (r₁)]. Thus, level 1a(r₁)(o).

6.16.5 SUMMARY

	LEVEL
Literal Interpretation	1b(r ₂)
Contextual Interpretation	4b
Purposive Interpretation	1b(s)
Judicial Interpretation	1a(r ₁)(o)

6.17 COMPANIES ACT 1989

6.17.1 LITERAL INTERPRETATION

The relevant parts of Section 9 of the Act are in essence the same as s236(2) and s237 of the Companies Act 1985.

The only other point to mention is s22 CA 89 which is the Interpretation Section. For the first time, reference was made to a legal definition of 'true and fair'. It says that 'true and fair' refers:

- (a) in the case of individual accounts, to the requirement of s226(2) CA 85
- (b) in the case of group accounts, to the requirement of s227(3) CA 85

s226(2) CA 85 states:

"The balance sheet shall give a true and fair view of the state of affairs of the company as at the end of the financial year; and the profit and loss account shall give a true and fair view of the profit or loss of the company for the financial year."

s227(3) CA 85 states:

"The [group] accounts shall give a true and fair view of the state of affairs as at the end of the financial year, and the profit or loss for the financial year, of the undertakings including in the consolidation as a whole, so far as concerns members of the company."

Looking at the three statutory provisions above, it seems that the meaning of true and fair still remains undefined and unclarified. Section 22 CA 89 makes reference to s226(2) and s227(3) CA 85 but neither of the sections throw any further light. All they appear to say is that the identified financial statements shall give a true and fair view but no more. It seems to be going in a circle. In view of the statutory provisions here being similar to the Companies Act 1985, the literal conclusion remains as before, ie level 1b(r₂).

6.17.2 CONTEXTUAL INTERPRETATION

As section 9 only seeks to reshuffle the provisions in the 1985 Companies Act, the contextual provision s228 CA 85 is now shifted to s226 under s1 and 4(1) of the Companies Act 1989.

There are no new contextual statutory provisions in this Act to aid in further insight. The conclusion will remain as before with the 1985 Companies Act (the principal Act) at level 4b.

would be unnecessary, supplemented by the fact that they were not aware of any pressure from the auditing profession for changes of the law on this particular point. (per Lord Strathclyde and Lord William in the House of Lords, Session 20 March 1989c col 516-7).

Mr Hanley's statement is as follows:

"The law, on one hand, is too complex and, on the other not comprehensive enough. It cannot be made in the interests of any of us who want to see properly agreed legislation fully carried out if the auditors on whom the directors, the DTI and shareholders rely, are seen to be muddled and uncertain about those interpretations....The existing law must be simplified and improved in the interests of all by starting again from first principles, offering greater simplification and clarity....The longer the law continues unchanged, the longer the defects and ambiguities will be allowed to continue."

(House of Commons, Session 3 May 1989 col 321-2)

So it seems the law affecting auditors still remains to be simplified and clarified.

6.17.4 SUMMARY

	LEVEL
Literal Interpretation	1b(r ₂)
Contextual Interpretation	4b
Purposive Interpretation	1b(s)

6.18 ENVOI

This chapter has sought to apply the bracketing stage of EISI where the statutory provisions under the Companies Acts relating to the auditor's duties towards fraud detection were isolated for definitional interpretation under the four canons: literal, contextual, purposive and judicial.

The interpretations were then coded and summarised at the end for each of the captured Companies Acts. All in all, 15 Companies Acts were involved in this process. An overview summary of all the coded statutory mini interpretations was drawn up but in view of it being required more in the next chapter to plot the micro graphs, it has been inserted there (see under Section 7.2, Figure 7'2).

In bracketing, the researcher holds the statutory text up for more detailed content analysis. It is removed from the body of the statute, taken apart and dissected systematically. In doing so, its elements and essential structures are uncovered, defined and coded according to the clarification system designed in Figure 6.3. Preconceptions to the standard meaning of words examined are suspended and put aside during bracketing. It rediscovers the meaning of the statutory words from a fresh literal, contextual, purposive and judicial angle. It is believed that such a method of inquiry in terms of the exegesis will provide the gateway into a system of larger and deeper meanings. For such meanings unfold as it is being defined and interpreted.

The bracketing stage has sought to address the second framed H₂ question of: What were the extent of those statutory duties in the context of fraud detection?

Having obtained the 'fruits' in the above question, it is now necessary to proceed to 'cultivate the fruit' to the next stage of EISI; construction where these unitised mini interpretations are built up into micro units under each of these canons of statutory interpretation. This leads us on to the next chapter: the micro stage.

CHAPTER 7

THE MICRO STAGE

7.0 PRELUDE

"Once upon a time, a Persian queen wanted to teach her four sons an important lesson. So she told the eldest to go in winter to see a mango tree, the next to go in spring, the third in summer, and the youngest in the autumn.

After the last son had returned from his autumn visit, the queen called them together to describe what they had observed. 'It looks like a burnt old stump', said the eldest. 'No', said the second, 'it is lacy green'. The third described it as 'beautiful as a rose'. The youngest said, 'No, its fruit is like a pear'. And they began to argue vehemently over it, each claiming that the others were lying and they each have the right answer.

Four hours later they were still arguing over it. The queen re-entered the room and said 'Each is right for each of you saw the tree in a different season.' And she quietly left the room to let them ponder on the 'real' lesson".

Paul Saw (1991)

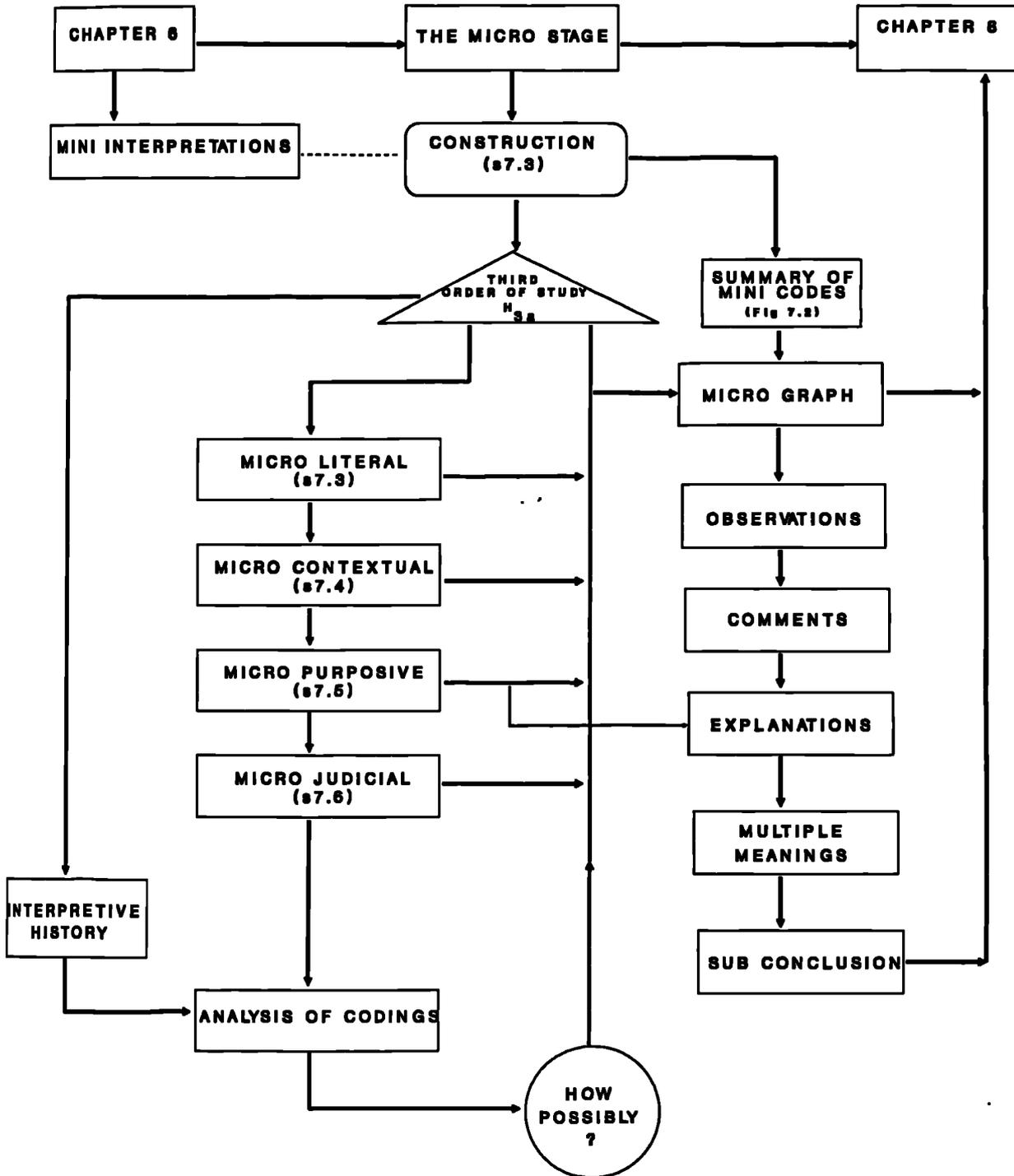
7.1 INTRODUCTION

This chapter seeks to carry out the construction phase of EISI. As shown in Figure 7.1 this is the third order of study and examines how the auditor's duties towards fraud detection have landed on those coded levels under each of the four canons of statutory interpretation.

This chapter begins with a recap on the essence of construction which is then opened up into four main sections, one for each of the statutory canons: literal, contextual, purposive and judicial. For each of these sections, there will be mapped out a micro graph, followed by observations on the graph and accompanied by comments which provide some interpretive explanations and meanings to it. A sub conclusion paragraph is also included to mark the end of that section. It should also be added that there is an extra explanation section in the micro purposive section for the epiphanies on the micro purposive graph since it is the purpose that generates the sociological epiphanies and there was availability of access to archival Parliamentary materials. Campbell and Wiles (1979) stated that the explanation of order may be of central concern but for human beings, the active, meddling, utopian dreamer, the question of change is more exciting. The Acts incorporating change have also provided for much debates in which reformers and obstructionists fought in both Houses, as so evidenced in Hansard.

The separate graphs will be superimposed in the next chapter where a macro study is carried out.

Figure 7.1 : FRAMEWORK OF CHAPTER 7



7.2 CONSTRUCTION

Construction in the EISI process orders and reassembles the phenomenon back together in terms of its essential parts, pieces and structures into a coherent picture. It involves securing the multiple categorised cases that embody the phenomenon in question and mapping out the transformations graphically.

As bracketing dissects the phenomenon, construction puts it back together again, but this time with the added knowledge gained from the bracketing stage.

So, construction builds on bracketing by reassembling the dissected phenomenon back together in terms of its essential historical parts. The range of mini definitional interpretations gathered in the previous chapter needs to be constituted into a micro picture under each of its analytic canons of interpretation. This is summarised categorically in Figure 7.2.

The summarised coded brackets were then constructed into four micro graphs which were used to address the third framed H3a question of: How did those duties end on on those levels? What does it mean?

The constructed micro graphs will be used to facilitate observation, comment, explanation and the generation of meanings. The comment sections provide an interpretation of the dynamics and complexities of interpreting statutes whereas the explanation section (as explained in the introduction section) refers to the purposive section which starts to raise some explanatory social, political and economic issues for the epiphanies there. With the experiential insights gained from compiling the mini stage, one is trying to move to another, lower resolution level (a 'micro' one) to see what meanings and implications can be further exposed in the four modes of statutory interpretation.

Figure 7'2 : SUMMARY OF THE CODED STATUTORY MINI INTERPRETATIONS

Companies Act	Literal	Contextual	Purposive	Judicial	Counsel 1	Counsel 2 (auditor's)
Joint Stock Companies Act 1844	1b	1b	1b(a)	-	-	-
Joint Stock Banks Act 1844	4b	4b	1b	-	-	-
Joint Stock Companies Act 1856	1b(v)	1b(v)	4a(v)	-	-	-
Companies Act 1862	1b(v)	1b(v)	4a(v)	(1887) 1b(v)	1b(v)	4b(v)
Companies Act 1878	1b(r5)	1b(r5)	1b(r5)	(1895) 1b(r1)	1b	4b
Companies Act 1900	1b(r5)	1b(r5)	1a(r5)	(1906) 1b(o)	n/a	n/a
Companies Act 1907	1b(r4)	1b(r4)	1a(r4)	-	-	-
Companies (Consolidation) Act 1908	1b(r4)	1b(r4)	1a(r4)	(1912) 1b(r3)(o)	2b(r5)	1b
				(1925) 4b	2b	4b
Companies Act 1929	1b(r4)	1b(r4)	1a(r4)	-	-	-
Companies Act 1947	1b(r2)	1b(r2)	1b(a)	-	-	-
Companies Act 1948	1b(r2)	1b(r2)	1b(a)	(1967) 1a(r1)	n/a	n/a
Companies Act 1967	1b(r2)	1b(r2)	1b(a)	-	-	-
Companies Act 1981	1b(r2)	4b	1b(a)	-	-	-
Companies Act 1985	1b(r2)	4b	1b(a)	(1990) 1a(r1)(o)	n/a	n/a
Companies Act 1989	1b(r2)	4b	1b(a)	-	-	-

7.3 THE MICRO LITERAL STAGE

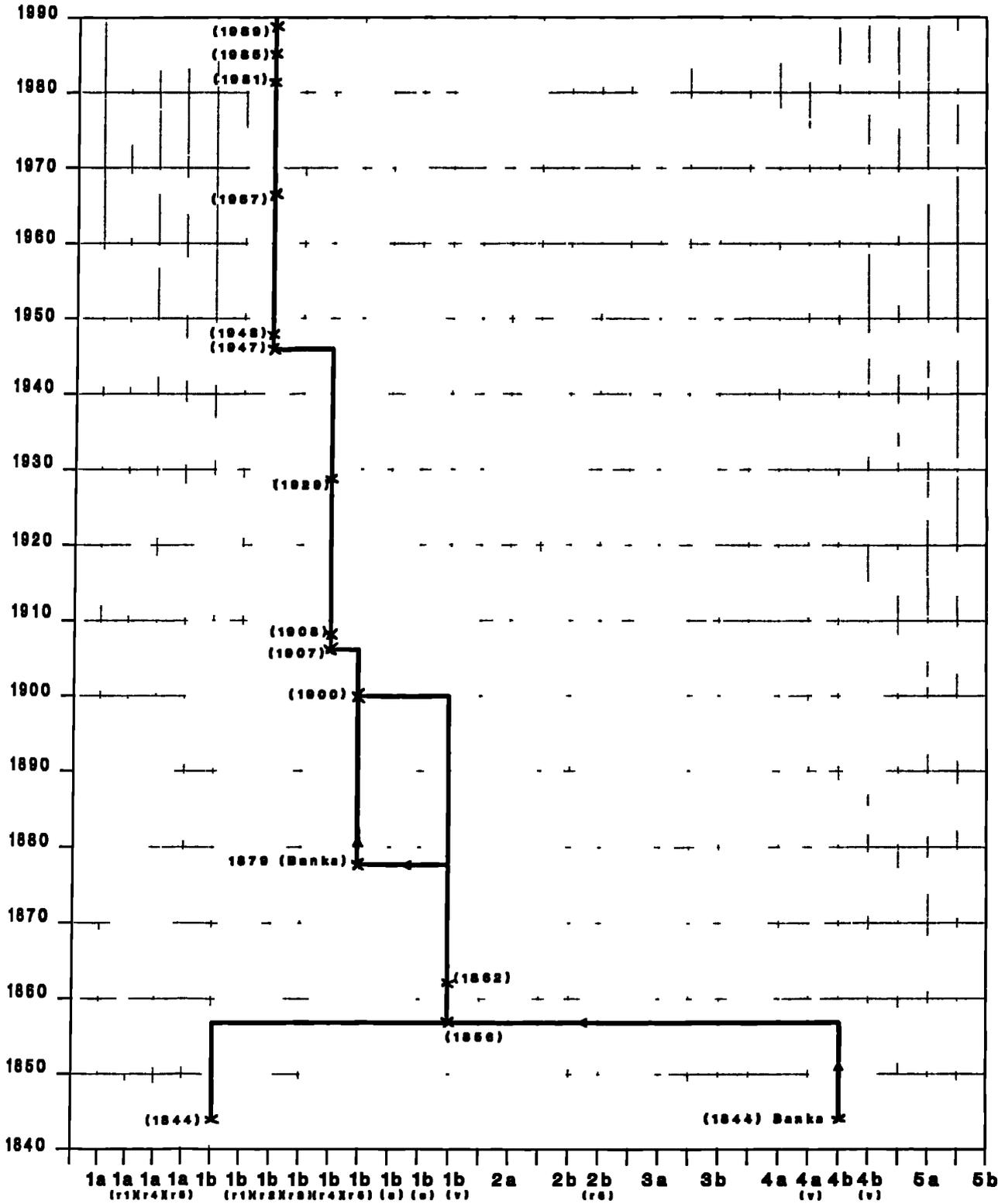
7.3.1 MICRO LITERAL GRAPH

The coded mini literal definitional interpretations are now constructed and shown graphically in Figure 7'3.

7.3.2 OBSERVATION

From the graph, it appears (with the exception of the Joint Stock Companies Act 1844) that there is a gradual and steady progressive upward translation of literal responsibility towards fraud detection over time, starting with level 4b in 1844 (the Joint Stock

Figure 7-3 :
MICRO LITERAL GRAPH



Graph reads this way

Banks Act) for the next 12 years. From the voluntary audit in 1856 till 1900, it was on level 1b(v); with the exception of banking companies' audits (made compulsory from 1879), which shifted it to level 1b(r₅). As all companies were required to have a compulsory statutory audit again from 1900, the levels merged into 1b(r₅), till 1907 which shifted it up one step to level 1b(r₄) for the next 40 years. The 1947 Companies Act requirements lifted it up to level 1b(r₂) and remained at that level right through the next four Companies Acts till today.

It appears that on the basis of this upward translation, the Government has gradually intervened through an Act of Parliament and legislated for the auditor a duty to detect fraud in an increasingly regulated manner. For example in 1844, the literal duty for banking companies (level 4b) was for fraud detection to be arranged between the parties in contract. This right of privity was gradually eroded in 1856 when the voluntary audit (under the regulations of Table B) carried a literal duty [level 1b(v)] to detect fraud. When the audit became compulsory again in 1900 for all registered companies, there was a literal duty [level 1b(r₅)] to detect fraud, but that responsibility was restricted to fraud within the books. The literal responsibility was narrowed in 1907 when the duty [on level 1b(r₂)] was restricted to the books with information and explanations given. Subsequently post 1947, the literal duty [level 1b(r₂)] was even made narrower and less onerous by requiring the fraud detection responsibility not only to be restricted by the books with information and explanations given but by materiality. It must have been a big relief for the auditors in holding them not responsible for failure to detect immaterial fraud, in contrast to the prior position on level 1b(r₄). The literal duty under statute law seems to have become more specific and narrower over time.

7.3.3 COMMENT

7.3.3.1 PROGRESSIVE SPECIFICITY

On the issue of progressive specificity upon the statutory duties, this may have become established following the emergence and recognition of the legislative supremacy of Parliament, as opposed to the legislative role of the law-lords in the medieval times. If the law of the nation is to be developed centrally as in UK by Parliament, it also considerably hastened the development of more exact statutory duties, to enable it to

be understood and carried out by the average reasonable auditor, the so-called ordinary auditor on the 'Clapham Omnibus'.

There is also the legal maxim **IGNORANTIA JURIS NON EXCUSAT**: ignorance of the law does not excuse. With respect to this 'presumption of legal knowledge', it means that the statutory duties of the auditor must be observed, and a deviation from them entails consequences detrimental to the auditor. Pixley (1976) states that as it is very necessary that everyone holding an office of a public nature should clearly understand his legal responsibilities, an auditor should be acquainted with the Acts of Parliament under which his appointment is made.

Thus, ignorance of the law does not excuse the auditors so as to exempt them from the consequences of their acts, irrespective of the clarity of the words drafted into statute law. It is in the legal sense that 'all men are presumed cognisant of the law' that must be appreciated and understood, and given its importance in the role of literal specificity under statute law. Broom (1982) asserted that it is quite evident that ignorance of the law, in reality, exists. Hence, the Government's seemingly efforts to reduce such ignorance by becoming progressively specific.

7.3.3.2 CLARITY

Whilst company law has advanced on progressive specificity, it has not complemented it with clarity. For example, the Joint Stock Companies Act 1856 became more specific on the auditor's duties than the previous Companies Acts, by requiring the auditors to expressly state whether satisfactory explanations or information have been given by the directors. This begs the question as to what is 'satisfactory'? The application of this adjective, by definition is very subjective, in the absence of expressed statutory guidance. What is satisfactory to one auditor may not be so to another auditor. This 'satisfactory' requirement continued through the Companies Act 1862 till 1879 for banks and 1900 for the other companies when it was completely withdrawn. It took about half a century for Parliament to 'realise' its vagueness and to remove this subjective statutory requirement, but only to be reintroduced as 'best information and explanations' in 1907 till today. What is 'best'? Is the adverb transcendental, personal or socially determined?

7.3.3.2.1 TRUE AND FAIR

Other examples are phrases such as 'full and fair', 'true and correct', 'true and fair' which are legal concepts for the auditors to deal with. Take the classic case of the phrase 'true and fair' which first appeared in the Companies Act 1947 (and subsequently in the Companies Acts 1948, 1967, 1985) but no attempt was made to define it by the Act's draftsmen. A further problem of the lack of statutory definition of the concept of 'true and fair' is the difficulty of determining whether it is a single concept or a two-part concept.

The obligation to give a true and fair view is declared to be overriding, notwithstanding the detailed provision relating to the form and content of accounts. In other words, accounts must not comply with the detailed requirements, if this would prevent them from giving a true and fair view. It is a phrase which has become so familiar to the auditor that it forms an undefined part of his daily accounting language. The statutory meaning of the phrase 'true and fair' is to say the least, elusive, yet it is clearly important that auditors and accountants, not to mention other potential users of accounts understand its meaning and implications. To have such a situation of apparent literal vagueness is strange to a profession with a public reputation for 'precision'.

This situation has undoubtedly existed for many decades and it is therefore reasonable to ask the dangerously simple question of why the concept of 'true and fair' has remained undefined by statute for so long, as it is a legal term and is central to financial reporting practice.

It is almost as if accountants have collectively and subconsciously agreed that 'truth and fairness' is something that requires no interpretation: that its meaning is known to every producer, auditor and user of external financial statements without formal announcement. Lee (1982) commented that to suggest such a complete and widespread understanding of such a complex term in a very technical function is stretching the imagination to say the least. After all, studies carried out by Lee and Tweedie (1977, 1981) reveal strong evidence of lack of understanding of even more straightforward matters in financial statements.

It was only in the Companies Act 1989 that a formal but a feeble attempt was made to define the phrase 'true and fair' under the new section 262 Companies Act 1985 (Minor Definitions Section). This point will be taken up again further on (s7.3.3.2.3).

7.3.3.2.2 JUDICIAL APPLICATION

Literal clarity is also important from a judicial point of view when confronted with applying the wording of the statute to the facts of the case. Miers and Page (1990) noted that the judiciary's insistence on interpreting Acts of Parliament according to the precise words used has a historical significance.

In cases of doubt towards the statutory provisions, judges seem to refer to binding precedents rather than looking into the intention of Parliament as the purpose of the legislation. These attitudes found expression in the presumption that changes in the statute law must, if they were to be enforced by the Courts, be expressed in the clearest possible terms. It is neatly captured in Lord Diplock's remark in *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg (1975) AC 591 at 638* that:

"Parliament is sovereign only in respect of what it expresses by the words used in the legislation it has passed."

One of the main consequences, noted by Miers and Page (1990) of these attitudes was the unwillingness of the Courts to extend the statutory words to cover the CASUS OMISSUS: the inexplicable and probably inadvertent failure of the draftsman to use words entirely apt to cover the instant case. The draftsman's response was to draft legislation with even greater degrees of specificity (as evidenced by the graph climbing upwards on the 1b level), a response which will further encourage the literal mode of interpretation. In drafting, it must be remembered that one must seek to give effect to what the words of the statute would be reasonably understood to mean by those whose conduct it regulates.

7.3.3.2.3 STATUTORY DEFINITION/INTERPRETATION SECTIONS

A literal interpretation can be justified based on the Definition/Interpretation Section contained in an Act.

Modern statutes frequently contain (usually in Companies Acts, at the end) a set of provisions with the marginal note 'Interpretations' or 'Definitions'. These usually take one of two forms, stating either that a particular word or phrase 'means...' (or 'has the meaning whereby assigned to it') or that a particular word or phrase 'includes...'. The distinction is important because, when an Interpretation Section states that a word or phrase 'means...', any other meaning is excluded, whereas the word 'includes' indicates an extension of the literal ordinary meaning which continues to apply in appropriate cases.

"The word 'include' is very generally used in interpretation clauses in order to enlarge the meaning of words or phrases occurring in the body of the statute; and when it is so used, these words or phrases must be construed as comprehending, not only such things as they signify according to their natural import, but also those things which the interpretation clause declares that they shall include."

[per Lord Watson, in Dilworth v Stamp Commissioner (1899) AC 99 at 105-6]

Fourteen out of the fifteen Companies Acts (the exception being Companies Act 1879) where a literal interpretation could be carried out contained the Definition/Interpretation Section. Their primary function seems to be to clarify words and phrases by assigning specific meanings to them, or by setting limits upon their normal meaning. A second possible function is to shorten legislation, so that the clarification will not need to accompany the word each time it appears in statute. So far as the Definition/Interpretation Sections go, they are part of the enactment in which they appear and must be treated as any other enacting part of it. But both these functions of clarification and shortening legislation do not appear to be carried out on the provisions affecting the auditor's duties.

It was discovered that thirteen (out of the fourteen) of the Definition/Interpretation Sections were silent as to the terms affecting the auditor's duties such as true and correct, confirm, etc. Only the latest Companies Act 1989 s22 made a feeble attempt to define legally by inserting a new section 262 into the Companies Act 1985 which further cross-referenced it to the amended sections 226(2) and 227(3) of the Companies Act 1985. The latter sections in essence stated that the accounts shall show a true and fair view without further clarification. In view of this circular and counter cross-referencing, the term true and fair still remains undefined and unclarified (refer to s6.17.1). It is seen as a poor attempt since a modern draftsman ought to draft in a manner so as to make the term clearer in status than before.

Overall, as far as the Definition/Interpretation Sections go, it has been of little or even no assistance in throwing further light for the purposes of interpreting the statutory duties literally. It would have been disappointing for the conscientious law-abiding auditor in trying to understand his statutory requirements through this avenue. It raises the question of the effectiveness of the Definition/Interpretation Sections in elucidating the meaning of statutory words, especially those relating to the auditor's duties.

7.3.3.2.4 INTERPRETATION ACTS

To a limited extent, the interpretation of certain statutory words is also regulated by the Interpretation Acts of 1850, 1889 and 1978. They operate as a standing dictionary of words used in legislation. It was found that they specify the manner in which references to gender, number, distance and time of day are to be interpreted and defines certain terms in common use, such as 'United Kingdom', 'Bank of England' and 'Secretary of State'. Like the definitions contained in the Act, these apply unless the contrary intention appears. Nevertheless for the purposes of interpreting the auditor's duties literally, the Interpretation Acts have not been able to shed any light on clarifying those statutory responsibilities.

7.3.3.2.5 DICTIONARIES

We now turn to dictionaries, which though they are not to be treated as authoritative did provide some assistance towards clarifying the meanings. It was found that persistent recourse had to be made to the dictionaries to ascertain the meaning of the statutory duties, due to the failure of the Interpretation Acts and Interpretation Sections to shed any light. This might have been a major avenue for statute users in the past. But many dictionary definitions are subject to the qualification, variously expressed, that they apply unless the context otherwise requires. Dictionary definitions may indeed complicate matters for interpreters, in particular where they specify novel or unusual meanings, and like the provisions which they qualify, they use language which like all definitions, may require further definitions and interpretations to clarify the terms in the explanations given by the dictionary. The Shorter Oxford Dictionary used by the judges also provides multiple definitions which are capable of an almost vast gradation and shades of meaning. Hughes (1991) observed that the most common 500 words have 14,000 different definitions and some words have more than 100 different quoted

meanings. This is coupled with the fact that though there are around 600,000 words available in English, most educated adults only use around 2,000 words.

As experienced in the mini literal stage, literal interpreters will need to examine all the range of definitions given and will have to exercise judgement in choosing the definition which most reflect the intention and spirit of the statutory words by considering the composition, syntax and grammar of the sentence construction. This was realised in trying to ascertain the meaning of terms affecting the auditor's duties such as fair, full, true, correct, etc.

Take for example, the term 'fair' as defined (with its various meanings) in the Shorter Oxford Dictionary (1985):

- A) A periodical gathering of buyers and sellers, in a place and at a time ordained by charter or statute or by ancient custom.

- B) I (1) Beautiful to the eye, of pleasing form and appearance
(2) Desirable, reputable, considerable
(3) Of language: elegant
(4) Attractive at first sight or hearing: specious, flattering

- II Of complexion: light as opposed to dark

- III (1) Free from blemish or disfigurement; clean, clear of a line curve or surface
(2) Free from normal stain, unblemished
(3) Free from bias, fraud or injustice, equitable, legitimate
(4) Tolerable, passable, average

- IV (1) Favourable
(2) Likely to succeed, promising, advantageous, suitable
(3) Gentle, peaceable, not violent
(4) Free from obstacles, unobstructed, open
(5) Clear, distinct, plainly to be seen

As seen in the example illustrated on the word 'fair', there is a wide range of meanings [A-E(3)]. Though the primary meaning was identified as B III(3), it does carry with it other possible meanings which can be coaxed out of the word 'a fair balance sheet' by argument such as

- a) an average balance sheet [B III(4)], due to the subjectivity of accounting conventions
- b) a suitable balance sheet [B IV(2)], which is useful to the readers
- c) a clear balance sheet [B IV(5)] as opposed to it being vague with aggregation of assets and liabilities
- d) a legible balance sheet [D] in terms of writing and presentation

The distinction between the different usual meanings of words and phrases is important for interpreters of statutes because they have to decide which sense is most appropriate in the particular context. The distinction between usual or primary meaning on the one hand, and secondary meaning on the other hand, is important for the interpreters because, from time to time, they may have to opt for a secondary meaning on account of the inconvenience, injustice or absurdity of applying any of the primary meanings to the situation before them. The question of whether a particular interpretation gives the words a meaning they will not bear is crucial because to do that is not interpretation; as there is a no-man's land between interpretation and making statutory provisions not made by the legislature where words are 'read in' to a section of a statute.

Dictionaries must also be used with caution in certain situations. The value of such sources is limited as when for example, the interpreter is concerned with the meaning of a word at a particular date. Hence the date inserted with the dictionary definitions in Chapter 6 as to when the word was first brought to use and eliminated if not in use. The search for definitions gets more complex when instead of a single word, it turns into a two-word phrase 'full and fair'. Is it to be interpreted and sought to be understood as two single separate words/meanings or one phrase/meaning?

Furthermore, it raises another question of whether the term 'fair' should be construed as a technical word passed with reference to the accounting domain. Lord Esher stated the theoretical position with regard to the admissibility of evidence concerning the meaning of words on questions of interpretation when he said:

"If the Act is directed to dealing with matters affecting everybody generally, the words used have the meaning attached to them in the common and ordinary use of language. If the Act is one passed with reference to a particular trade, business or transaction, and words are used as everybody conversant with that trade, business or transaction knows and understands to have a particular meaning in it, then the words are to be construed as having that particular meaning, though it may differ from the common or ordinary meaning of the words."

[Unwin v Hanson (1891) 2 QB 115 at 119]

Bell and Engle (1987) noted that it may be that evidence of the ordinary meaning of statutory words can be theoretically inadmissible, although it may be received in practice comparatively frequently. When it is agreed or contended that statutory words have a technical meaning, evidence with regard to that meaning is unquestionably admissible, and it should generally be preferred to information gleaned from other sources such as dictionaries. But the difficulty here is that the distinction between an ordinary and a technical meaning is not all that easy to draw as mentioned in *R v Jordan (1977) AC 699*.

Does the word 'fair' carry statutorily an undefined technical meaning besides its ordinary meaning. It is very difficult to draw any further meaningful conclusions.

7.3.3.2.6 PRINCIPLES OF LANGUAGE

In applying the principles of literal interpretation mentioned earlier, it was realised that the principles of language applicable to all written instruments apply to statutes as well. Many of the so-called rules of interpretation or canons of construction are but ordinary principles of language. At its most general, the implication of this observation is that statutes are to be read subject to the same principles of composition, syntax and grammar as a novel or a work of non-fiction. This means that in essence, there is a major and continuous role of subjective judgement to be played in this seemingly 'objective' process of statutory interpretation.

7.3.3.3 IMPLICIT vs EXPLICIT

It should be noted here that all the 15 Companies Acts carry an implicit duty to detect fraud when literally interpreted. It is interesting to observe that fraud detection has not been legislated as an explicit provision under the Companies Acts, meaning that there is no clear expressed duty to detect fraud. This is evidenced by the fact that none of the graph lines did manage to reach level 1a, the explicit duty. Does this mean that it is impossible for the auditor to undertake full responsibility to detect all fraud? Or that the costs of so doing will outweigh the benefits or savings from fraud abuse? As seen from the graph the implicit literal duties (post 1856) also carry some scope of qualification or limitation to the scope of fraud detection. The graph lines exist on levels 1b with provisos (r₂, r₄, r₅, v).

7.3.3.4 LENGTH

As the duties become more specific, the words drafted in the Companies Acts also became more and more lengthy. This was evidenced in the progressive lengths across a sample of the Companies Acts 1844, 1856, 1900, 1947, 1985 and 1989. Perhaps the classic case is the Companies Act 1947, which in the auditor's duties section had around 500 words compared with the similar section in the Joint Stock Companies Act 1844 which had only 56 words. The equivalent section in the Companies Act 1985 had around 460 words. With the increasing length also emerged the dangers and problems of verbosity, comprehending and ascertaining the essence of the statutory duties coupled with the increasing need for cross-referencing within and into other Acts.

Acts were also amended or added to regularly, as there were 41 major Companies Acts over 145 years (approx 1:3.54 years). This is further analysed in the table below (Figure 7.4).

Figure 7.4 : SUMMARY OF AMENDING AND CONSOLIDATING COMPANIES ACTS 1844-1989

Co Act No	Period	Amending Acts	Consolidating Acts
1-22	1844-1907 (63 years)	(22 Acts)	
23	1908		(Consolidation No 1)
24-28	1910-1928 (18 years)	(5 Acts)	
29	1929		(Consolidation No2)
30	1947 (1 year)	(1 Act)	
31	1948		(Consolidation No3)
32-38	1961-1984 (23 years)	(7 Acts)	
39-40	1985		(Consolidation No4)
41	1989	(1Act)	

7.3.3.4.1 USER'S NEEDS

In 1970, the Heap Report argued that the procedures by which statute law is made and promulgated should be governed by the needs of the user. It identified the user's basic requirements (para 101) as:

- a) all legislation, including Statutory Instruments, on a particular subject be contained in its latest form in one place;
- b) the statute law be expressed in that place comprehensively; there should be one subject for each Act, and one Act for each subject; and
- c) a convenient method exists to enable him easily to find the particular subject matter sought.

Company law as a whole single entity has never been systematically organised into principal Acts each dealing with an individual subject. Companies Acts are still classified chronologically rather than by subject matter so that a single Act may deal with several different subjects (eg CA 1989 deals with company accounts, auditors, mergers, financial markets, insolvency and amendment to the Financial Services Act 1986). Conversely, a single subject may be, and usually is, dealt with in a multiplicity of statutes (presently, the auditor's duties are in the Companies Acts 1985 and 1989).

Moreover as shown in the table above, the system of amending legislation (with the exception of Companies Act 1947) is not geared to maintaining the structure of the consolidated or codified Act as a unit. The amendment system in general use here is what is known as the referential system.

7.3.3.4.2 REFERENTIAL SYSTEM

The referential system of amendment makes it difficult, if not impossible for the law on a particular subject to be contained in a single text in one volume. The user may consequently require to have several volumes of statutes open in front of him at any one time. He then requires to reconcile the texts of two or more statutes which bear on the same topic. Perhaps the classic case is the period prior to 1908 whereby references may extend to 23 Companies Acts. It was only in 1908 that a consolidation Act was passed to re-enact in a single Act of existing provisions (covering 63 years) of company legislation. It is difficult to ascertain except by extensive research (which may involve individual users substantial expense) whether or not the provision of a particular statute represents the current law without an up-to-date text of the consolidating Act.

What could be further improved is for all cross-references of section numbers in an amended Act to have brackets highlighting the heading and vice-versa. It does not carry much meaning for the user of the statute to register for example, that the auditor has to report that the annual accounts have been properly prepared 'in accordance with the provision of this act', without specifying the section numbers of the provisions (evidenced in the Companies Acts of 1844, 1856, 1862, 1879, 1900, 1947, 1948, 1967, 1981, 1985, 1989) or that it has to comply with a section number of an Act without specifying a brief heading of what it is about (evidenced in the Companies Acts 1947, 1948, 1967, 1981, 1985). Only the latest Companies Act 1989 s9 (inserting the amended s237(4) CA 85) made a cross-reference to the subject matter of Schedule 6. Whether it is a genetic representation of future Companies Acts is yet to be seen, as this was not clearly visible in other sections of the 1989 Act.

Perhaps there is also a need for more frequent consolidations to be carried out since all cross-references and amendments would be available in one Act to facilitate understanding and interpretation. There are only 4 consolidating Acts covering nearly 150 years of company law history. No consolidating Act is due in spite of the massive amendments in the 1989 Companies Act.

The Hill Report (1970) recommended changes to the system by which amendments are made in the existing law so that it will be possible to maintain the law as initially consolidated perpetually up-to-date and accessible in its up-to-date text in a convenient form to the user. For this purpose in so far as practicable, changes and amendments should be made by the textual method of amendment in preference to the referential method. In other words, an immediate consolidating Act after each amending Act, as seen in the 1947 Companies Act.

What seems to be emerging is that the root of the problem afflicting the comprehension by statute law users lies more in the system by which law is made and expressed than in the substantive law itself.

7.3.3.5 PRIMACY OF WORDS

As legislation increased in quantity and as it came to deal more and more with matters unknown to the common law, the importance and necessity of literal clarity of statutory words will be increased. Primacy, though not total supremacy, needs to be given to the words of the statute. As the Companies Act is directed to dealing with matters which affect a wide range of people generally, the words used needs to have meanings attached to them in the common and ordinary use of language.

If primacy is to be given to literal clarity, then the text is conceived as an object capable of bearing meaning independent of the interpreter (and indeed of the author's possible intentions), and is considered to be in large measure self-interpreting. Within a formalist tradition, such a proposition encourages a belief in the determinacy of the text and in the validity of attending primarily to its linguistic components as the 'definitional meaning' that this proposition asserts is contained within it. It is this approach which underlies the traditional understanding that when interpreting legislation, the primary constitutional duty of the judge is to give effect to the intention of Parliament as expressed in the words of the statute.

This duty in turn imposed two fundamental constraints on the manner in which the judge should perform that duty. The first is that where the words of a statutory provision clearly apply to the facts of a case, the Court must give effect to them, no matter how unpalatable it considers the result to be. This was emphatically reasserted

by Lord Diplock in the House of Lords case *Duport Steel v Sirs (1980) 1 ALL ER 529 at 541*.

"My Lords, at a time when more and more cases involve the application of legislation which gives effect to policies that are subject to bitter public and Parliamentary controversy, it cannot be too strongly emphasised that the British Constitution, though largely unwritten, is firmly based on the separation of powers; Parliament makes the laws, the judiciary interpret them. When Parliament legislates to remedy what the majority of its members at the time perceive to be a defect or a lacuna in the existing law (whether it be the written law enacted by existing statutes or the unwritten common law as it has been expounded by the judges in decided cases), the role of the judiciary is confined to ascertaining from the words Parliament has approved as expressing its intention what that intention was, and to giving effect to it. Where the meaning of the statutory words is plain and unambiguous it is not for the judges to invent fancied ambiguities as an excuse for failing to give effect to its plain meaning because they themselves consider the consequences of doing so would be inexpedient, or even unjust or immoral."

The second constraint is that a judge must reject a definitional interpretation which the words of the statute cannot sustain, even where it seems to him that such an interpretation would give effect to what he understands to be Parliament's intention in passing the Act. In applying statutory words to a particular set of facts, judges are expected to elucidate their meaning and scope, but where the statutory words as elucidated do not cover the facts at hand, it is not the judge's function to devise interpretations based upon what he thinks the draftsman would have said in such circumstances. Lord Simon in *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg (1975) AC 591 at 645* said that a judge should give effect to the meaning of what Parliament has said and not what Parliament meant to say. This is in reality only another way of saying that a judge should not re-write the legislation, for this is the exclusive right of legislature.

7.3.4 SUB CONCLUSION

'Ordinary' and 'primary' meanings are often used as synonyms for the 'literal role' or 'grammatical' meaning of words, as in the phrase 'literal rule'. But when applied to the construction of statutes, 'literal' is often used pejoratively. Then, it is the meaning which results from giving to each word an ordinary meaning without much reference to the context and applying the provision to a particular situation without regard to its purpose.

Take for example, s41 of the Joint Stock Companies Act 1844, requiring the auditor to 'confirm' the accounts which carries with it an ordinary meaning of an affirmation duty. But the scope of that affirmation duty could not be determined if the contextual application of s35 is not brought into the requirement to 'confirm' that the accounts and balance sheet are full and fair.

Presumably, this is the kind of thing which Stephens J had in mind when he said in *Re Castioni* (1891) 1 QB 149 at 167 that it is not enough for the drafting of Acts of Parliament to attain to a degree of precision which a person reading them in good faith can understand, but it is necessary to attain if possible to a degree of precision which a person reading in bad faith cannot misunderstand. The words 'if possible' were well chosen. Bell and Engle (1987) argued that relatively little of what has been said in a statute can be said in such a way that it may not be reduced to utter nonsense by a strictly literal and wholly unimaginative construction.

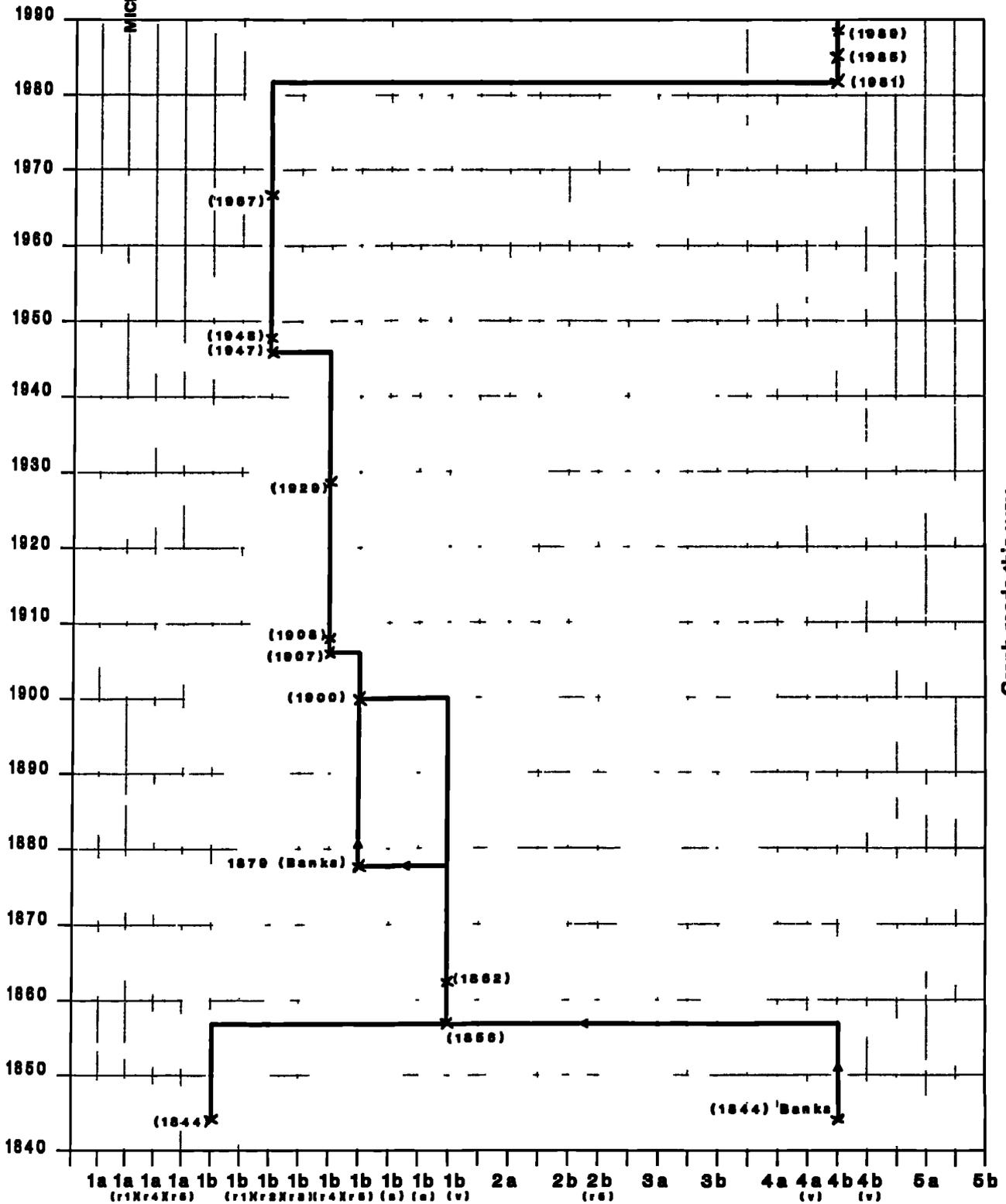
In this section, it was shown that whilst the auditor's statutory provisions have advanced on progressive specificity at the cost of progressive lengths, it has not complemented it with clarity through the introduction of phrases such as 'full and fair' or 'true and fair'. The Definition/Interpretation Sections found in the Companies Acts nor the Interpretation Acts were able to assist towards clarifying the statutory provisions. Constant recourse had to be made towards the dictionary coupled with the growing realisation that the finer principles of language had to be employed to open up the statutory meanings, albeit very much on an implicit level. The issue of the user's needs were highlighted in this rather inconvenient referential system of amendment adopted in the Companies Acts. It concluded with a reminder that primacy, though not total supremacy needs to be given to the statutory words if the literal clarity of statutory words is to be increased.

7.4 THE MICRO CONTEXTUAL STAGE

7.4.1 MICRO CONTEXTUAL GRAPH

The coded mini contextual definitional interpretations are now constructed into the graph shown in Figure 7.5.

Figure 7.5 :
MICRO CONTEXTUAL GRAPH



Graph reads this way

7.4.2 OBSERVATION

The contextual graph appears to be nearly isomorphic to the literal graph. Except for the two ends of the graph, it is on a general upward translation with respect to time. At the start of the graph, the divergence of level 1b in contrast with level 4b was further confirmed by the contextual section 35 of the Joint Stock Companies Act 1844. Post 1981, the contextual graph dips to level 4b due to the contextual understanding (CA 1981 - s1&2, CA 1985 s228, CA 1989 s1&4) of the requirement to show a true and fair view.

It was found that out of the 15 applicable Companies Act examined, 10 (67%) of the Acts (1844, 1856, 1862, 1907, 1908, 1947, 1948, 1981, 1985, 1989) had additional contextual provisions to be referred to within the same Act. They have either modified or reinforced the literal understanding of the statutory duties. Hence, an obvious source from which arguments based on the statutory language may be developed is the rest of the Act in which the (unclarified) words appear. Cross (1976) stated that it is scarcely necessary to cite authority for the proposition that Acts must be construed as a whole. Guidance with regard to the meaning of a particular word or phrase may be found in other words and phrases in the same section or in other sections although the utility of an extensive consideration of parts of the same statute will actually vary from case to case.

7.4.3 COMMENT

The upward translation only seeks to reinforce the point made in the micro level stage that the general trend seems to be Parliamentary intervention for a progressive statutory duty to detect fraud. However, post 1981, the contextual interpretation seems to indicate that the Government has relegated its control on the auditor to detect fraud since by then, the duty was to be arranged implicitly between the parties in contract (level 4b).

7.4.3.1 ALTERNATIVE MEANINGS

Of the ten Acts mentioned above, three (1981, 1985, 1989) offered contextual understandings which led to a conclusion which differed substantially from the literal

conclusion (level 1 vs level 4). Thus, it can plausibly be contended that there can be more than one possible meaning when the context is brought in.

The contextual sections would appear to remove some doubt from the literal words used and in a sense offer a more accurate interpretation since words derive their meaning from their context. Take for example, the requirement to show a true and fair view under s236(2) of the CA 1985. There needs to be a further clarification of what the term actually means. A literal interpretation based on dictionary meanings leads it to level 1b(r₂). But with the aid of the contextual section 228 CA 85, it modifies the true and fair meaning to that of complying with the statutory provisions regarding the form and content of company accounts to level 4b.

Lord Justice Stamp emphasised the importance and role of contextual interpretation quite well when he said:

"English words derive colour from those which surround them. Sentences are not mere collections of words to be taken out of the sentence, defined separately by reference to the dictionary or decided cases, and then put back again into the sentence with the meaning which you have assigned to them as separate words, so as to give the sentence or phrase a meaning which as a sentence or phrase it cannot bear without distortion of the English language. That one must construe a word or phrase in a section of an Act of Parliament with all the assistance one can from decided cases and, if one will, from the dictionary, is not in doubt; but having obtained all that assistance one must not at the end of the day distort that which has to be construed and give it a meaning which in its context one does not think it can possibly bear."

[Bourne v Norwich Crematorium Ltd (1967) 2 ALL ER 576 at 578]

On the other hand, six out of the ten Companies Acts (1856, 1862, 1907, 1908, 1947, 1948) available with contextual sections provided the same conclusion as for the literal interpretation. This provided further comfort to the literal conclusion.

It seems that the proper application of the literal rule does not mean that the effect of a particular word, phrase or section is to be determined in isolation from the rest of the statute in which it is to be contained. It should also be appreciated that once a contextual section has been identified, a literal interpretation still needs to be carried out on that contextual section as evidenced in the mini contextual stage.

7.4.3.2 IMPLICIT vs EXPLICIT

Nevertheless, what was identical with the literal stage was that the levels were all implicit levels again. This means that the contextual sections also do not provide clear expressed guidance to auditors on fraud detection. Again, the implicit conclusions reached were due more to the language drafted in statute law by the draftsman rather than the nature of the audit itself.

7.4.3.3 CROSS-REFERENCING

Moreover, in reading a statute, Parliamentary counsel have the inconsiderate habit of not telling you (for example in a footnote or marginal note) that a particular key word in the section carries a contextual section somewhere else in the statute. Currently one has to ferret out the information for oneself.

As contextual sections are essential to remove doubts or even alter the understanding of a section or words of an Act, it would be useful for cross-references (footnotes or marginal notes) of contextual sections to be drafted into the structure of the Act. Otherwise how would one be able to identify the relevant contextual sections expeditiously without laboriously reading through the whole Act, bearing in mind that for some Acts, eg Companies Act 1985 alone is about 650 pages long.

As we saw in the discussion above, the meaning of statutory words is determined not by reference to any subjective intentions of the legislators but by reference to the sense which an informed legal interpreter would give to them in the context in which they are used. The context requires the interpreter to situate the disputed words within the section of which they are part and in relation to the rest of the Act.

7.4.3.4 JUDICIAL APPLICATION

For some time, the law relating to statutory interpretation was bedevilled by the notion that it was wrong for a Court to look beyond the words with which it was immediately concerned if their meaning was clear when they were considered in isolation. Blackstone (1765) had said that recourse should only be had to the context if the words happen to be still dubious. This notion gained further support from Tindal C J's

advice to the House of Lords in the *Sussex Peerage Case (1844)* 11 CL & FIN 85 at 143:

"If the words of the statute are in themselves precise and unambiguous, then no more can be necessary than to expound those words in that natural and ordinary sense...But if any doubt arises from the terms employed by the legislature, it has always been held a safe means of collecting that intention, to call in aid the ground and cause of the making of the statute...which is a key to open the minds of the makers of the Act."

It was found that in all the fifteen Companies Acts examined in detail there were recurring doubts arising from the statutory terms employed. The literal rule did provide some insight but was unable to provide the colour which surrounded those terms. It is difficult to believe that the notion of literal construction in complete isolation was ever taken wholly seriously. Nonetheless, even in the 20th century, it has proved necessary for appellate Courts to administer mild rebukes to judges for their isolationist approach to statutory construction. The wisdom of the following comments by Lord Greene, M R in *Re Bedie (1948)* 2 ALL ER 995 at 998 are worth noting.

"...in construing words in a section of an Act of Parliament one has to not to take those words in vacuo, so to speak and attribute to them what is sometimes called their natural or ordinary meaning. Few words in the English Language have a natural or ordinary meaning in the sense that they must be so read that their meaning is entirely independent of their context. The method of construing statutes that I prefer is not to take particular words and attribute to them a sort of prima facie meaning which you may have to displace or modify. It is to read the statute as a whole and ask oneself the question: 'In this state, in this context, relating to this subject-matter, what is the true meaning of that word?' In the present case, if I might respectfully make a criticism of the learned judge's method of approach, I think he attributed too much force to what I may call the abstract or unconditioned meaning of the word...The real question which we have to decide is what does the word mean in the context in which we find it here, both in the immediate context of the sub section in which the word and in the general context of the Act."

7.4.4 SUB CONCLUSION

A final point to note here is that all the 15 Companies Acts looked into had the term 'shall' drafted in. The somewhat quaint statement that a statute is 'always speaking' appears to have been originated in Lord Thring's (1902) exhortations to draftsmen concerning the use of the word 'shall':

"An Act of Parliament should be deemed to be always speaking and therefore the present or past tense should be adopted, and 'shall' should be used as an imperative only, not as a future".

(p82)

But the proposition that an Act is always speaking is often taken to mean that a statutory provision has to be considered first and foremost as a norm of the current legal system, whence it takes its force, rather than just as a product of an historically defined Parliamentary assembly. Bell and Engle (1987) states that it has a legal existence independently of the historical contingencies of its promulgation, and accordingly should be interpreted in the light of its place within the system of legal norms currently in force. Such an approach takes account of the viewpoint of the ordinary legal interpreter of today, who will normally apply ordinary current meanings to legal texts, rather than to embark on a research into linguistic, cultural and political history, unless he is specifically put on notice that the latter approach is required. The inclusion of a telephone within the notion of 'telegraph' in the Telegraph Act 1869 is an example of this approach.

In this section it was contended that there can be a shift to an alternative meaning when the contextual provisions are brought in. Cross-referencing should be drafted into the structure of the Act to assist in this contextual search, even if the conclusions reached were on the implicit level. The Courts, it seems, have been dragged in different directions in its attitude towards contextual interpretation.

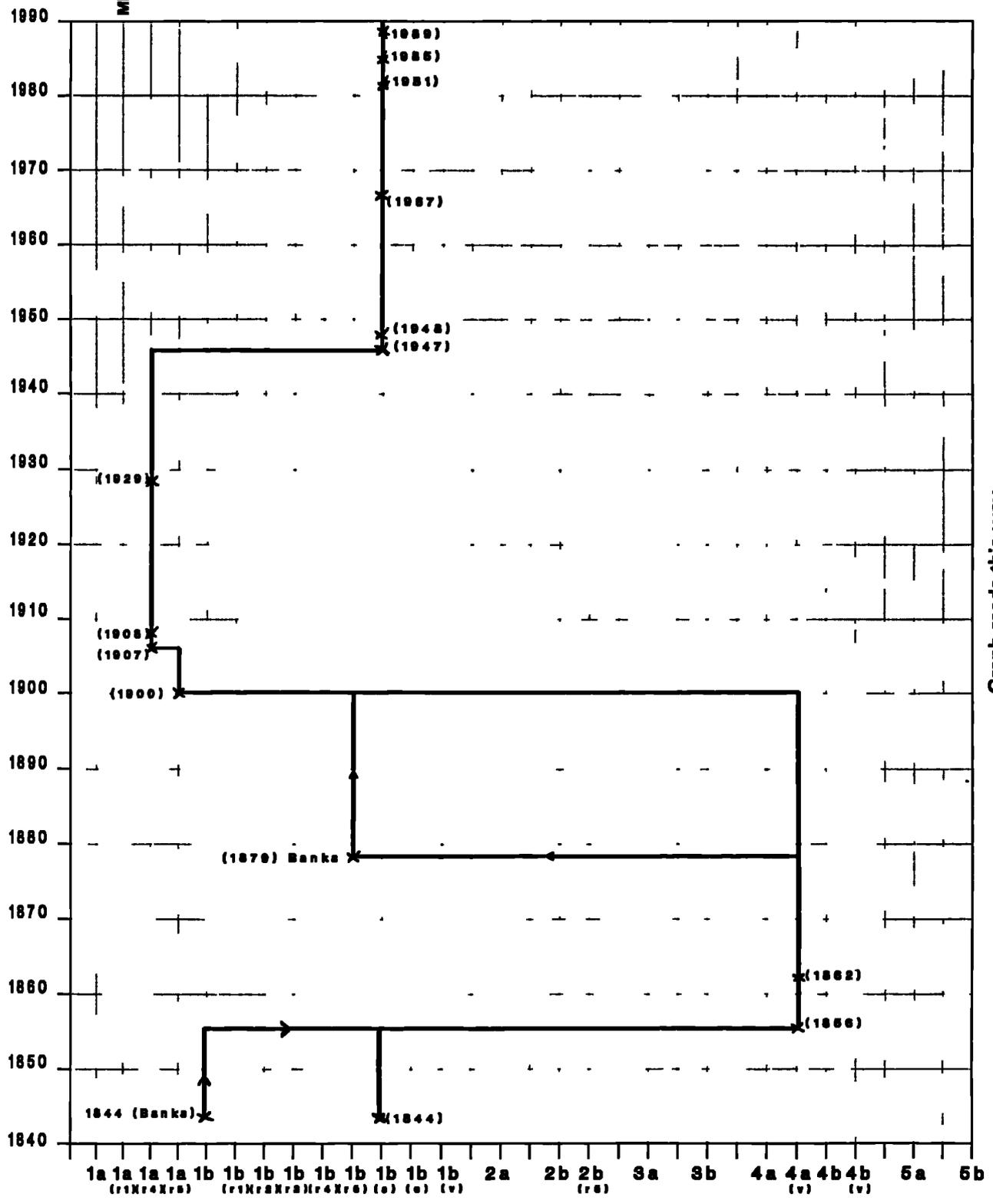
Thus, a contextual understanding can either modify or reinforce the literal understanding of the statutory provision.

7.5 THE MICRO PURPOSIVE STAGE

7.5.1 MICRO PURPOSIVE GRAPH

The coded purposive definitional interpretations are now constructed into the graph shown in Figure 7.6.

**Figure 7-6 :
MICRO PURPOSIVE GRAPH**



Graph reads this way

7.5.2 OBSERVATION

The micro purposive graph generally tends to resonate fairly steadily on level one (creation of explicit and implicit fraud detection responsibility through statute), starting in 1844 with level 1b(s) (for companies) and 1b (for banks). The situation was shifted downwards temporarily in the period 1856-1900 to level 4a(v) but was translated upwards for the period 1879-1900 (for all banks) to level 1b(r₅). When the compulsory audits were reintroduced in 1900, the levels merged even higher at level 1a(r₅) till 1907 when it reached level 1a(r₄). That level remained till 1947 when it dipped to level 1b(s) which carried on till today.

What this means is that using the purposive approach, there is some duty to detect fraud. One would argue that this would be a more exacting duty as the purposive duty was backed up by evidence from Parliamentary materials, the source of all legislation. This 'exacting' duty would be further reinforced at the exoteric resolution level by the fact that there were six explicit duty levels [ie (a) category] emerging for the first time in the canons so far.

The dip from 1856-1900 to level 4a(v), making the duty one of contractual privity was expected in view of the audit being made voluntarily. Nevertheless and because it was on the explicit level (a), this means that there was still a purposive fraud detection duty when the voluntary audit was contracted.

Auditors of banking companies tend to receive a higher duty for fraud detection when they were singled out over a period in the specific Companies Act as seen in 1844 and 1879. In 1844, the banking companies were on level 1b, whereas the other companies were on the lower 1b(s) level. This schism was even wider in 1879 when the banking companies were on level 1b(r₅) in contrast with the other companies at level 4a(v). The higher duty demanded could have been due to the wider social effects and misery of banking frauds in history and also as evidenced so recently by BCCI.

7.5.3 EXPLANATION

This section is devoted to the aspect of relationships between statute law and society. Law is used as a diagnostic tool to uncover structural preconditions which in other areas remain tacit and less readily observable.

Here in trying to offer some plausible explanations of the way the graph (Figure 7.6) is shaped through the intention or purpose of the legislature, one has to trace it back to Government Committee Reports and Parliamentary Debates. The explanation focuses on the epiphanies or turning points of change in the levels on the auditor's duties towards fraud detection, starting from the 1844 Joint Stock Companies Act. The deeper understanding gained from this section will be used to project further interpretations in the next section 7.5.4.

7.5.3.1 JOINT STOCK COMPANIES ACT 1844

Gower et al (1979) noted that many of the (bubble) companies were from their inception fraudulent shams, particularly the bogus assurance companies such as those pilloried by Dickens in his 1843 book titled *Martin Chuzzlewit* and it was primarily the existence of these which led the Board of Trade to secure the appointment in 1841 of a Parliamentary Select Committee on Joint Stock Companies. Under the chairmanship of Gladstone, the epoch-making report (Gladstone Committee Report, 1844) led to the drafting of the Bill which became the Joint Stock Companies Act 1844.

It can be gathered from the Gladstone Committee Report that the widespread occurrence of frauds perpetrated through the Bubble Companies were the immediate occasion of the inquiry and to call for the adoption of direct measures of prevention.

Mr Gladstone, in moving the second reading of the Joint Stock Companies Bill in the House of Commons (Session 10 June 1844 col 476) said that the main provisions went to give a statutable position to Joint Stock Companies, subjecting them to general inspection and providing for their constitution and regulation. Mr Hawes reminded the House of Commons (Session 3 July 1844 col 273) that the great object of the Committee which sat on this subject (Joint Stock Companies) was to prevent the formation of fraudulent companies.

With the evidence gathered, the Select Committee categorised the bubble companies into three classes but the first two will be of relevance here only.

Firstly, those which are faulty, or fraudulent in their object, being started for no other purpose than to create shares for the purpose of jobbing in them, or to create under

pretence of carrying on a legitimate business, the opportunity and means of raising funds to be shared by the adventurers who started the Company.

With this class, the Select Committee saw the remedy as follows; that by publication of the list of the directors and the shareholders, the Deed of Settlement, the amount of the capital, and whether subscribed or not subscribed, would hinder those situations of fraud which have come under the notice of the Select Committee. The public would have the means of knowing with whom they deal. The agents and bankers would be enabled to avoid participating in the discredit of such concerns, by giving the sanction of their names to questionable undertakings. Surprisingly, there is no mention of the audit as part of the remedy here towards the fraudulent companies.

Secondly, those which let their objects be good or bad, are so poorly set up as to render it likely that the miscarriages or failures incident to mismanagement will arise.

The difficulty is greater with the second category of companies for good objects but ill constituted. But as seen in s6.3.3, the Select Committee recommended the introduction of the audit (besides more internal periodical checking and accountability) as the answer to the mismanaged companies. The compulsory audit would be the mechanism which would primarily ensure that there would be a check on the mismanagement of companies through indifference or carelessness. In making management more accountable to shareholders the audit then, by implication also served the secondary purpose of dealing with fraud. Hence the emergence of level 1b(s).

7.5.3.2 JOINT STOCK BANKS ACT 1844

There is very little historical material on the banking audits here. But the following extract from the Minutes of Evidence in the Peel Report (1836) may provide some explanation for the introduction of the compulsory audit to banking companies.

Q654: [Sir Robert Peel] *"Do you consider that the power reserved to the proprietors, under your Deed of Settlement, of appointing auditors in order to inspect the accounts in detail, and to be furnished with satisfactory evidence that the general statement made by the directors is correct, is a useful power in your deed of settlement?"*

[Mr J Amery, General Manager of a Bank] *"I do, and giving the public all the protection that they can want."*

Q655: [Sir Robert Peel] *"Do you consider that it would be desirable by law to provide that such a power should be reserved to proprietors, in respect to all joint stock banks?"*

[Mr J Amery] *"I think it would be desirable that all joint stock banks should be under the same control."*

It seems that the evidence to Q654 was used as the basis for introducing the s4(7) compulsory appointment of auditors by shareholders under the Deed of Settlement. It was replied in Q655 that the statutory appointment of auditors to inspect the accounts in detail for correctness submitted by the directors would be very desirable in offering protection to all joint stock banks. Hence the emergence of the implied duty, 1b.

7.5.3.3 JOINT STOCK COMPANIES ACT 1856

As mentioned in s6.5.1, the compulsory audit was reverted to voluntary status. The graph now dips to 4a(v), the next epiphany.

It appears that this move was probably due to:

- a) the ineffectiveness of the 1844 Joint Stock Companies Act to regulate fraud, in the context of the registered status of companies as 'traps to the unwary'.

"It seems, then, upon the opinion of very competent witnesses, that these (Companies) Acts, so far from having been a means of preventing fraud, have only afforded facilities for its commission, because fraudulent persons have availed themselves of the sort of prestige which is gained among ignorant people by a presumed association with the Government, and have announced companies as 'established by Act of Parliament' or as 'provisionally registered' and have thus given them a colour of respectability which their own merits would not obtain...But not only do these provisions prove nugatory - they serve as traps to the unwary. They give credit to unsound and unsubstantial concerns, and in a great degree facilitate those very frauds which they were intended to prevent."

(Mr Lowe, House of Commons, Session 1 February 1856 col 123-4)

- b) the contemporary feeling that matters of accounting (eg auditing) should be dealt with by private contract between shareholders and auditors. The mentality was that if they want it, they can ask for it. State intervention was disliked.

"The principle is the freedom of contract...the right of people to make what contracts they please on behalf of themselves, whether those contracts may appear to the legislature beneficial or not, as long as they do not commit fraud, or otherwise act contrary to the general policy of the law."

(Mr Lowe, House of Commons, Session 1 February 1856 col 129)

The House of Commons was in full support of the 'laissez faire' approach. Mr Malins (House of Commons, Session 1 February 1856 col 140) joined in by saying that he had always taken his stand upon the question that a man should be free to enter into any contracts that pleases him. He also felt it was the duty of legislature to give the greatest facility to the public to ascertain the precise nature of those contracts.

- c) the provisions of other statutory safeguards in the 1856 Act, in place of the compulsory audit such as the Board of Trade investigations, the appointment of Inspectors and the voluntary audit and the limited liability of shareholders.

7.5.3.4 COMPANIES ACT 1879

The next epiphany must have sent out rippling waves of panic throughout the nation via the catastrophic failure in 1878 of the City of Glasgow Bank, in a setting of directoral mismanagement and falsification of accounts. The banking company had been registered - but without limited liability for its members - under the Companies Act 1862. By overvaluing assets, undervaluing liabilities and particularly significant in a bank - misdescription of balance sheet items with the object of maintaining the company's credit standing, directors had for a number of years successfully concealed its vast insolvency while continuing to pay dividends, a multi-million fraud for which they received in due course, terms of imprisonment. As was explained in s6.7.3 the Glasgow Bank fraud immediately precipitated the Companies Bill 1879 which reintroduced a compulsory audit for all banks incorporated with limited liability.

As the compulsory audit provisions and duties were being debated, there were some reservations as to the effectiveness of the audit. Mr Heygate (House of Commons, Session 22 July 1879 col 999) said that he was no great believer in the safeguards which had been suggested, or in the possibility of the Bill providing against all danger of loss. He quite agreed that it was necessary that the public should be kept safe, but what was required for true security was a solvent set of shareholders and a solvent and

honest set of directors. Mr Hubbard (House of Commons, Session 29 July 1879 col 1543) added that he had no great faith in periodical audits but had faith in a true candid (accounting) statement made in a shape that the public could understand.

Mr Baring (House of Commons, Session 29 July 1879 col 1557) took up the mood by saying that the audit could not protect shareholders from fraud on the part of the directing and managing body and any attempt to do so would fail. He quite recognised that the failure of the City of Glasgow Bank was not caused by ignorance on the part of those who administered the affairs of that establishment, but by the fraudulent practices in which the directors and officials indulged. The audit, he believed could do no good, but it could also do no harm.

Dr Cameron attacked the proposed audit as a delusion, a fallacy and a sham. He added:

"Nine-tenths of the banks at present had all the audit they would have under the Bill, but no one was wiser for it. The radical defect in the present system was that the auditors were the nominees of the directors. Auditors would unwillingly pass false returns, but they did not examine fully into the accounts. Things were made pleasant, and they found their salaries paid the more willingly the less work they did, and an audit took place which was popularly known as the 'sherry-and-sandwich' audit. This Bill provided for a little extension of that sherry-and-sandwich audit, and nine-tenths of the banks had that audit already. Auditors were nominally in limited liability banks appointed by the shareholders; but in almost every case the directors held proxies and controlled the appointment of auditors."

(House of Commons, Session 22 July 1879 col 989)

To this, Mr Mundella (House of Commons, Session 12 August 1879b col 858) agreed with other members of the House that they could not, by any precaution which might be taken, make Boards of Directors honest.

The Chancellor of the Exchequer, Sir Stafford Northcote (House of Commons, Session 12 August 1879b col 858) having appreciated the arguments put forward so far commented that whilst he is for the audit, he does not think it would be wise for Parliament to attempt to prescribe a particular form of audit, or to impose upon the auditors a duty which they could not discharge.

Sir Andrew Lusk (House of Commons, Session 12 August 1879 col 860) while admitting the usefulness of a proper audit, thought that the Committee should guard themselves from enacting the provisions of this clause in a haphazard way. By the

clause as it stood, the auditor could do just what he liked; inquired into the affairs of the bank, and then come upon the directors and examine them.

The matter appears to have settled towards the end of the Commons Session (12 August 1879b) by the following two comments made.

Mr Hankey *"...agreed with the Chancellor of the Exchequer that the (audit) clause should stand. It was not perfect but it indicated a certain form and a certain examination to be gone through..."* (col 857)

Mr McLaren *"...anyone who had experience of the auditing of accounts, either directly or indirectly, would know that the very fact that accounts were to be audited was, in itself, a safeguard."* (col 860)

From the debates above, it seems that Parliament also had its fair share of problems in interpreting the statutory words 'correct', 'true and correct', 'full and fair', 'as shown by the books'. It created very different views between certain members of what the audit should actually be. Sir Andrew Lusk at the end of the Committee Report requested that the provision in the audit clause should be re-examined so that it is not enacted 'in a haphazard way'. But for some reason, it seemed to have fallen on deaf ears, probably due to Parliamentary time running out.

The Bill was passed through, being as vague as from the outset on the auditor's duties. The Chancellor of the Exchequer feared that if the actual scope of the audit was spelt out (coldly from the House) in a more precise manner, the auditor may not be able to discharge it. By the clause as it stood, the auditor could determine his own precise attainable standard. It was recognised that the clauses were not perfect but indicated a certain examination which in itself was a safeguard. But as Mr Heygate pointed out it was not a safeguard against all loss (fraud or otherwise). The best safeguard it seems, is honesty from within, ie an honest board of directors which Mr Baring said could not be regulated at all.

But one may ask, what has happened to the predominant 'laissez faire' philosophy of the Government towards the audit, back in the 1860s. In fact, throughout the Parliamentary debates, there were constantly two engaging socio-political issues.

Firstly, of laissez faire. The Chancellor of the Exchequer, Sir Stafford Northcote stated:

"With regard...to (the) audit, we desire to be distinctly understood as repudiating in any way, Government interference with the matter. We do not desire...that the audit should be conducted by a Government Department or under its direction"
(House of Commons, Session 21 April 1879a col 799)

"As regards the suggestion which had been made of Government interfering and laying down a stereotyped form of audit, read the City articles in the newspapers for the last fortnight...commenting on different systems of audit introduced by different joint stock banks...to inspire confidence in the public."
(Mr Mundella, House of Commons, Session 22 July 1879a col 1022)

It seems that the argument put forward was that the pressure of the audit being reinstated was initiated by the press. Nevertheless, Mr Forster pointed out in the House of Commons (Session 12 August 1879 col 857) that by adopting the compulsory audit, the Government were stepping out of their proper province in interfering with the management of banks, and that the results might be precisely opposite to those at which they wished to arrive. He added that directors might avoid the searching examination since it was impossible for them to do the work of the shareholders and to secure that, they should have an audit of this kind.

Despite its continuing policy of non-interference with commercial corporations, Parliament was willing to undertake responsibility for introducing measures to regulate companies if the public cannot look after themselves. With pressure coming from the public, Mr Lewis said:

"The House was not considering the Bill in a panic, but under the pressure of demands deliberately made in such a way as to render it the duty of the Government to throw upon the House the responsibility of rejecting (or accepting) a measure (such as the audit) for the relief, not of shareholders only, but equally of depositors and of the whole banking community."
(House of Commons, Session 29 July 1879 col 1547)

The second socio-political issue was the 'fire-fighting' approach to regulation. Mr Laing noted that the present Bill was in the nature of a panic Bill; *"it was brought in consequence of a panic"* (House of Commons, Session 22 July 1879 col 1024). It was he added, the movement of the public mind occasioned by the panic or uneasiness consequent amongst shareholders of the unlimited banks on the failure of the City of Glasgow Bank, which led to this legislation.

Mr Shaw may have wanted to prompt the Government to review its foresight role in regulation when he raised the point that:

"the consequent pressure experienced by banks had produced a state of feeling...(where they) were pressed on all hands to do something in connection with such (fraudulent) banks, and that was the origin of the present Bill. If it had been proposed last year to deal with the banking question, the great majority of those who (now) thought the subject called for legislation would have said that...anything approaching to a proposal to pick out unlimited banks for special legislation would have been set aside."

(House of Commons, Session 22 July 1879 col 1012)

The House did not seem to be interested in this self-appraisal and its lack of foresight was clouded by short term measures of allaying public panic and bringing credit back to the Government.

Mr Baring said that he did not assert that this Bill was a piece of panic legislation, but it certainly was introduced in consequence of panic and in order to avoid, if possible, fresh returns of panic (House of Commons, Session 29 July 1879 col 1553).

All the more, Sir Edward Colebroke:

"believed that the passing of this Bill (with its protective remedies), would give confidence to the public mind, that it would reflect credit on the Government and that it would allay a great deal of outside alarm"

(House of Commons, Session 29 July 1897 col 1552)

It seems from those multi-varied reasons above; 'to protect, give confidence, reflect credit and allay a great deal of alarm' led to the reinstatement of the banking audit to level 1b(r₅).

7.5.3.5 COMPANIES ACT 1900

The revival of the compulsory annual audit to all registered companies [the next epiphany to level 1a(r₅)] followed from an extensive inquiry conducted by the Company Law Amendment Departmental Committee of 1895, leading to the Davey Committee Report.

Lord Dudley, Secretary to the Board of Trade noted in the House of Lords, (Session 19 March 1896) that:

"The appointment of that Committee was due to the fact that for many years past the legislature had been pressed to take action with regard to certain evils that were alleged to be springing up under the Companies Acts; in fact, those evils were so apparent, that as far back as 1877, a Select Committee of the House of Commons was appointed to enquire into them...and they found that frauds and losses which had accompanied limited companies rendered further regulations in the formation of companies under the Acts expedient."

(col 1315)

Eventually, the Davey Committee was appointed under the leadership of Lord Davey:

"to inquire what amendments are necessary in the Acts relating to Joint Stock Companies incorporated with limited liability, especially with a view to the better prevention of fraud in relation to the formation and management of companies and to consider and report upon the clauses of a draft Bill."

(para 1)

The existing situation was that certain provisions exist to safeguard the interests of creditors and shareholders, amongst them a table of model Articles on the audit. But the fact that the adoption of that table was left purely optional, rendered it:

"of no value in just those cases where it was most needed...No doubt under the present law, a number of companies were formed which were doomed ab initio to failure entailing loss to shareholders and creditors alike. It was reported officially that one-third of the companies formed became permanent; in other words, two-thirds became insolvent. That was a very serious state of things, and the necessity for imposing restrictions became urgent."

(Lord Dudley, House of Lords, Session 19 March 1896 col 1316-7)

Sir Albert Rollit also expressed his concern from the House of Commons (Session 26 June 1900):

"The scandals in connection with companies are important in themselves, but they have even a very more important effect, namely, their destructive effect on trade and commerce. They have been the means of destroying the investment of capital and creating distrust which is most disadvantageous to commercial enterprises...I think the law ought to impose as many impediments as it possibly can against fraudulent acts, whether in connection with companies or otherwise, so as to prevent them to the utmost possible extent. I think this Bill is a move in the right direction. The necessity of caution has been referred to; and when we remember that some £1,500 millions are invested in these companies, the safeguarding of these enterprises is one reason for the exercise of great caution."

(col 1154-5)

The so-called 'evils' seem to rest on limited companies which impeded the pro-capitalistic thrust of the Government. Lord Dudley said:

*"The establishment of limited companies might, if unchecked, lead to considerable abuse, and open the door to a considerable amount of fraud."
(House of Lords, Session 19 March 1896 col 1316)*

Incorporating the insights from s6.8.3, it appears that limited companies being aware of their limited liability privilege were abusing it by 'involving large risks' imprudently which ended up in bankruptcy to the detriment of creditors mainly. The draft Bill was introduced in 1896 in the House of Lords. The investigation in the House of Lords Committee occupied the sessions of 1896, 1897, 1898 and 1899, and the result from it was an amending Bill. Amongst the omissions were surprisingly that of the compulsory audit and the definition of the duties of auditors. The reasons for the omissions were not highlighted by the House of Commons but may be inferred from the discussions carried out earlier by the House of Lords Committee. Below are some of the relevant discussions.

Lord Herschell said in the House of Lords Committee (Session 19 March 1896) in relation to the Davey draft Bill,

*"Nothing could be more dangerous than for people to suppose that any amendment of the company law would protect them when they invested their capital in hazardous undertakings...The loss resulting from companies did not always involve fraud, because a vast number of companies which failed were started by over-sanguine persons."
(col 1322)*

It seems the House of Lords Committee has taken the doctrine of caveat emptor to the extreme in line with the laissez faire liberalism and that companies fail more due to imprudence than of fraud. Lord Herschell was more sceptical as to the value of the clauses which relate to the audit on the basis that it was impossible for auditors to be experts, able to judge the value of various kinds of properties - for instance, the bills and other securities held by bankers. He added that it would be a mistake to require too much from auditors or to believe that an audit, however well conducted could enable absolute reliance to be placed upon balance sheets.

The Lord Chancellor, Lord Halsbury may have had a decisive influence over the abolition of the reintroduced compulsory audit when in the early stages in the House of Lords (Session 19 March 1896), he said:

"It was of course quite true that an audit might be relied on too much, and the records of the Courts of Justice showed that the office was sometimes an illusory one. In many cases, the auditor took everything from the secretary who took it from somebody else, and the (Davey) Bill aimed at the prevention of scandals of that description."
(col 1325)

When the House of Commons met on 26 June 1900 to review the re drafted Bill, in the early stages there were consonant feelings with the House of Lords amendments. In the light of it, Mr Ritchie said,

"...in one year 1896, no fewer than 1261 companies went into liquidation, involving the loss of no less than fifteen million sterling, of which £8,284,000 were losses in capital. But although the figures are considerable, they yet are comparatively speaking, small compared to the enormous capital invested in public companies, which amounts at the present time to £1,500 million. Therefore, the losses in the year 1896 were only about 1% of the capital invested, and that fact should induce the House to approach the amending of the law relating to public companies with very great caution and circumspection.

I think that in considering the question we should endeavour as far as possible to secure that there should be no unnecessary interference with the freedom of companies in carrying on their business and in the general management of their affairs, and that we should be extremely careful not to make the law so onerous and so oppressive as to prevent the very best class of our businessmen engaging in the operations of these companies."

(col 1140)

Nevertheless there was a strong call for the reinsertion of the audit provisions again. Whilst it was the contemporary feeling that no legislation is fraud-proof, the audit was a 'wholesome check' to the directors. Sir Albert Rollit commented in the House of Commons (Session 26 June 1900),

"Impress on every director his obligation to use reasonable care and prudence in the exercise of his powers, and give a right of action to the shareholders in the event of a director departing from that great commercial principle (of honesty). I think it would be a wholesome check to directors if they knew that they would have to devote all their time to their duties, and that if they did not, they were under some liability to the shareholders."

(col 1158)

In the end, the House reinstated the audit provisions. Now that the compulsory audit is finally enacted, there still appears to be literal difficulties in interpreting the auditor's statutory duties. Mr Ogden (1895) stated that the position of an auditor would be made stronger if his duties were clearly defined and imposed by statute. This was attempted in the contents of the auditor's report of the Bill but as was pointed out by Mr McArthur in the House of Commons (Session 26 June 1900), it was still vague.

"In regard to the matter of auditors, I think that the description of their duties in the Bill is insufficient. It is necessary, not only in the interests of the shareholders but in the interest of the auditors themselves, that they should know what the duties are. It is very desirable that there should be some clear definition of what is required of auditors, and in particular that they should report whether in their opinion, full and fair balance sheets have been drawn up."

(col 1168)

The House however, appears to have ignored McArthur's very perceptive speech and went on to discuss other matters. The drafting of the wording of the statutes have been it seems, consistently left indeterminate. There seems to be an inertia to clarify and amend it statutorily. There was evidence, in the context of the earlier Companies (Banking) Act 1879, that the auditing profession had difficulty interpreting and was concerned about breaching the statutory meaning of those duties.

Mr Frederick Whinney, a leading audit practitioner, in giving evidence to the Davey Committee in 1895 said,

"that the auditing of the Banking Act 1879, should be altered so as to make the meaning clear, viz whether or not the duty of the auditor extends to anything beyond seeing that the balance sheet is correct according to the books."

(para 21)

"It is very desirable that the meaning of this section (in the 1900 Act) should be determined, so as to settle whether or not an auditor is bound to go beyond the books of the company."

(para 26)

"If the auditor confines his work merely to seeing that the balance sheet agrees with the books, the audit becomes worth very little, but it is a question whether the Act of Parliament throws any greater duty upon him. Most professional auditors, however consider that it is, at any rate, their duty to verify the actual correctness of the balance sheet so far as it is possible to be done."

(para 27)

The Davey Committee nor the Government nor the Act's draftsman embarked on Whinney's preceding requests. It was left to case law in *London & General Bank 1895 2 Ch 673* to address it as shown in s6.7.4.

7.5.3.6 COMPANIES ACT 1907

In 1905, the Board of Trade appointed the Warmington Committee to enquire what amendments were necessary in the Acts relating to Joint Stock Companies, and to report to the Board of Trade. A couple of days later, the Committee were informed that the reference had been framed in wider terms in order to prevent the exclusion of any subject which any member of the Committee might wish to bring before his fellow members. The Board of Trade expressed the assurance that the Committee will consider generally by what means Joint Stock enterprise can best be fostered and encouraged, as well as the means by which illegitimate (or fraudulent) practices may be most effectually repressed.

By way of preface, the Warmington Committee Report (1906) stated the attitudes or guiding principles that the Committee have assumed in approaching the problem of Company Law reform, amongst which was

"...it is desirable by all reasonable means to repress fraud."

(para 8)

In line with the Companies Act 1900 and the consequences for unsecured creditors when a limited company becomes insolvent, further reforms were made to protect this class of creditors. The 1906 Report noted that:

"Large as are these facilities (increasing accounting disclosure and publicity) - if creditors would avail themselves of them - for obtaining information about a limited company, we consider that the information available is still inadequate, and we recommend that for the protection of persons who may deal with a company, and may become its creditors, every limited company ought to be required to file periodically a statement of its affairs in the form of a balance sheet, containing a summary of its capital, its liabilities and its assets, giving such particulars as may generally disclose the nature of such liabilities and assets, and how the values at which the fixed assets stand are arrived at. Such balance sheets should be examined and reported upon by the company's auditors."

(para 33)

An interesting observation needs to be noted here in the Appendix to the Warrington Committee Report (1906). In preparing the Report, the Committee sought for comments on the amendments to the Companies Acts. One of those comments came from the London Chamber of Commerce regarding s23 of the amended Act which defined the auditor's duties.

"The auditors' certificate and report require better definition - especially showing whether these may be in one and the same sentence at the foot of a balance sheet, or whether a report external to the balance sheet is required. NB: The practice varies so amongst professional accountants owing to different interpretations of this section, that this would be a useful amendment."

(p79)

It appears that, on the wider front, the auditor's statutory duties need to be made more explicit literally. Auditors, it seems, are offering their own interpretations which do differ, not surprisingly. It may be due to the above comment that Parliament responded to make the duty more specific ('better defined'). Problems were already raised by the affected groups and Parliament on the previous 1900 Act as to what 'as shown by the books' actually mean, especially in the context of fraud detection. Perhaps with the addition of the statutory words in this 1907 Act 'according to the best of the information and explanations given to (the auditor)' Parliament has sought to absolve the auditor from failure to detect fraud in the books when he was given and defrauded by false information and explanations by management. This may explain the slight epiphanic shift upwards to level 1a(r₄).

7.5.3.7 COMPANIES ACT 1947

The next epiphanic shift to level 1b(s) came in 1947. It witnessed a formal recognition of a change of emphasis in both financial accounting and auditing. The Companies Act 1947 contained elaborate extensions to accounting and auditing provisions. It makes an attempt to standardise accounting treatment and contained a list of items of information which every company was to disclose, where relevant, in its financial statements. This was the introduction of a legally enforceable minimum disclosure level.

Every company was required to present annually to its shareholders a profit and loss account in addition to the previously required balance sheet.

A company with a controlling interest in another company was required, for the first time, to prepare and present to its shareholders consolidated financial statements describing the profitability and financial position of both companies aggregated together, in so far as these factors affected the shareholders. The statements produced were to be subject to the same information disclosure requirements as those for a single company.

Company auditors were expected to cope with this increase in the quality and quantity of financial accounting information being supplied to the shareholders, and the Act stipulated that the auditor must be a suitably qualified professional accountant except in the case of the small family type of company, defined for this purpose as an exempt private company.

This Act had its origins in the Report of the Committee presided over by Lord Justice Cohen. The Committee, which subsequently produced the Cohen Report (1945) had *"to consider and report on what amendments are desirable in the Companies Act 1929 and in particular to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded for investors and for the public interest."* (p1) As a result, the Bill proceeded with two principal objects - firstly, to restore or to strengthen the relationship between ownership and management and secondly, to bring fully within the ambit of the company law the modern system of holding and subsidiary companies.

The Cohen Report (1945) noted that the evidence obtained indicated that the great majority of limited companies, both public and private were honestly and conscientiously managed. In view of this, the Committee sought to relax its concern over fraud detection by auditors and introduced a legally enforceable minimum disclosure level, designed to give shareholders sufficient information about company affairs, and thereby to help to protect their investments. The Cohen Report (1945) stated that:

"The Companies Acts have been amended from time to time to bring them into accord with changing conditions, but if there is to be any flexibility, opportunities for abuse will inevitably exist. We consider that the fullest practicable disclosure of information concerning the activities of companies will lessen such opportunities and accord with a wakening social consciousness...We have included a number of proposals to ensure that as much information as is reasonably required shall be made available both to the shareholders and creditors of the companies concerned and to the general public."

(para 5)

Viscount Swinton, in the House of Lords (Session 17 December 1946) commented:

"The shareholder deserves all the information and protection which it is practicable to afford him...Both Greene Committee and now the Cohen Committee have testified that the vast majority of businesses are fairly conducted. They both also point out that the ingenuity of the occasional determined rogue will find a way round or through the most intricate maze that you can establish."

(col 1012-3)

The sudden shift in the focus to the 'fullest practicable disclosure of information' seem to stem from a rise in social consciousness by all parties on the increasing use being made of accounting information which needs to be refined and standardised. It may be due to the post-war rationalisation to maximise the use of limited economic resources by improving industrial and economic efficiency, to restructure the functioning of the capital markets and facilitate investor, creditor, and Government decision-making towards a planned economy.

The Cohen Report (1945) states that:

"The present legal requirements as to the contents of the accounts to be presented to shareholders are too meagre. The practice of showing a number of diverse items in one lump sum and thereby obscuring the real position as to the assets and liabilities, and as to the results of trading makes it difficult and often impossible for a shareholder to form a true view of the financial position and earnings of the company in which he is interested. While auditors have tended to press for standards in advance of the requirements of the present law, it has been suggested that their hands would be strengthened if the law were to accord more nearly with what they regard as the best practice."

[para 7(d)]

"The amount of information disclosed in the accounts (at present) of companies varies widely. The recent tendency has been to give more information and this tendency has been fortified by the valuable recommendations published from time to time by the responsible accountancy bodies as to the form in which accounts should be drawn up and the information which they should contain. The directors of many, but by no means all, companies now give shareholders as much information as they consider practicable and the accounts which they present contain much more detail than is required by law. Auditors use their influence to persuade directors to present their accounts in accordance with the principles laid down by the professional bodies to which they belong, but in the absence of statutory requirements, they cannot override the directors, and in some cases may be deterred from pressing their views by fear of losing their position as auditors. The professional bodies representing the accountants who gave evidence before us all agreed that the position of auditors would be strengthened if the law were to prescribe a minimum amount of information to be disclosed in all balance sheets and profit and loss accounts."

(para 97)

The rationale for increasing disclosure was also amplified in the House of Lords and the House of Commons. Viscount Swinton in the House of Lords (Session 1 April 1947) saw it as a requirement of stewardship accountability.

"What has been done with regard to the accounts is also very English and very practical. We have laid down the principle that those who are responsible for the conduct of a company must tell not only the true story but also the full story. These accounts must be informative..."

(col 964)

Lord Brand also commented that:

"...the fullest information and facts should be given wherever possible. This is particularly apparent in the First and Second Schedules of the Bill which relate to the accounts and audit which I think myself is one of the most important parts of the Bill..."

I am in favour of it for three main reasons. The first is that it is a very good way, I do not say to catch a scamp, but to stop a scamp from being a scamp. The second is that it is due to shareholders that they should have the fullest possible information. Nevertheless, even when you have done that, it is not all plain sailing...when you have given all this information, you have given it to the expert and perhaps it will gradually filter through, but very often you have not given it to the shareholder because it is more than he can stand. The third reason - and almost the most important - for having full information in my opinion, is that it is absolutely necessary for a planned economy...You (Government) must have the most accurate information if you are to plan at all."

(House of Lords, Session 17 December 1946, col 1032)

Mr Fletcher in the House of Commons (Session 6 June 1947) also shared Lord Brand's concern about the comprehensibility of the 'fullest possible information' when he argued that:

"Some 75 per cent of average shareholders cannot understand a balance sheet and 90 per cent do not read it. If therefore, not only for the protection of the shareholder but for his education and to make him a more useful member of the community which the public company is,...we are deluding ourselves...The shareholder does not read and cannot understand the accounts."

(cols 649, 650, 652)

Nevertheless, both Houses by majority, saw that the best safeguard that can be given to the shareholders is full disclosure of information, in spite of the points raised above.

In the House of Lords, the Lord Chancellor, Lord Jowitt said:

"But under modern conditions, I think that the best safeguard is to ensure that the fullest possible information is given to shareholders through the statement of accounts, and even though the individual shareholder may not always realise what is involved in these accounts, it should be revealed to the skilful reader...This is the principle of freedom with publicity which, on the whole, has worked well, and to which we attach the greatest importance."

(Session 17 December 1946, col 1004)

In the House of Commons, Sir Stafford Cripps said on 6 June 1947,

"(The Bill) will enable a better control to be exerted over limited liability companies by shareholders, and though it cannot of itself prevent failures, it can and does provide means whereby shareholders can exercise a more constant and intelligent control, which should go a long way to forestall failures arising from rash and unwise acts of directors...it is rather intended to confirm that standard, and to prevent or to reduce to a minimum, the exceptions which fall away from it."

(col 597)

Following from that, Mr Bracken added in the same Session that:-

"It is singularly appropriate that we should be dealing with a Bill like this at a time when by reason of the nationalisation of industry and for other reasons, many thousands of persons are turning away from fixed-interest securities to the purchase of ordinary shares. I hope this Bill may diminish some of the risks they must take in buying equities."

(col 599)

Perhaps, Mr Bracken in concluding summed it up quite well when he commented that taking it all in all, publicity is democracy's best watch-dog.

It seems that there is a relegation of focus from the auditor to public disclosure as the answer to combating fraud and offering protection for the shareholder.

In the House of Commons, Mr Fletcher said:

"The President of the Board of Trade used an extremely significant phrase in his admirable and clear speech when he spoke about control by informed opinion, which is really the finest and best form of control there can be. That informed opinion has to be kept informed in every possible way."

(Session 6 June 1947, col 648)

In the same session, Mr Morris (Session 6 June 1947, col 612) reminded the House that whilst the Bill was not brought in primarily for that purpose, it was to some extent still a check against fraud. The House realised that no Bill will ever abolish dishonesty or human inefficiency. In fact, the Cohen Report (1945) stated that the selection by the shareholders of the right governing body of each company would be more effective than by the provisions of any statute. Nevertheless, the provisions in this Bill were seen to be efforts to make fraud difficult for company directors. Viscount Maughan commented in the House of Lords (Session 17 December 1946) that:

"I cannot help welcoming the clauses in this Bill which are devoted if not entirely to stopping at any rate to making more difficult, the frauds which have been committed all the time...I would add this, because I think it is rather an important thing to bear in mind: that a clause is not to be struck out of a Bill because it does not do all that you want it to do. If it goes some part of the way, if it catches a certain proportion of rogues, then it is something which should be put on the Statute Book. I remember quite well a personal experience in connection with protection against burglary. You may do what you like in your house, and a skilful burglar may avoid it and break in, but you can make it so difficult for him that he would prefer to go elsewhere rather than tackle your house."

(col 1042)

The auditor's role in detecting fraud is also somewhat weakened by the insertion of s43(b) which allows the Board of Trade to carry out an investigation into the company's affairs if fraud is suspected. The insertion of this section came from the Cohen Report (1945),

"It seems to us important that observance of the requirements of the Companies Act should be vigorously enforced and still more important that where companies are improperly or dishonestly conducted, their affairs should be investigated and the offenders prosecuted."

(para 6)

The House of Commons appear to endorse such an enactment when Viscount Swinton said:

"The way to catch a man is by powers of inspection vested in the Board of Trade. Indeed the criminal law provides for such a position, if a man has done something wrong. That power of inspection, the power to be able to go into the company's affairs, will I believe, be a much better way of catching a rogue."

(House of Lords, Session 1 April 1947 col 966)

As a matter of interest, the 19th century laissez faire ethos seems to have lost much credibility by now. Mr Marquand commented:

"If there were free competition, it was thought, the inefficient would be destroyed. Those that destroyed them would be those best fitted to survive. But as we all know, when we are not being ideologies but we are looking at the real world, this is not how the capitalist system in any of the western developed countries works today. We have had the growth of what economists call 'imperfect competition' - the development of giant firms which can 'rig the market'. So the laws of unrestrained laissez faire capitalism no longer work in large parts of the private sector.

This is why it is necessary, to achieve the optimum allocation of resources of the Government to intervene in many ways...In addition, we should recognise that the modern private company is a massive agglomeration of social power and that its activities have repercussions on people's lives to such a degree that we cannot simply allow its activities to be regulated by economic considerations alone."

(House of Commons, Session 14 February 1967 col 403)

As a side issue, what has the function of the audit evolved into? Before that can be answered, it should be pointed out that the auditor's duties have never been clearly defined. The Association of Certified and Corporate Accountants commented in 1944 that the duties and responsibilities of auditors under the 1929 Act are far from being clearly defined and the elastic obscurities which surround some of those duties make the value of the safeguards which the law presumably intends to provide very uneven, and the standards applied by auditors to similar facts may materially differ.

The call for a clearer statutory definition was also reiterated by the Institute of Chartered Accountants in England and Wales when in 1945 they commented that whilst in practice the interpretation placed by auditors on their duties under the Companies Act 1929 involves responsibility in relation to the profit and loss account, the scope of their duties should in this respect be defined more explicitly. On this point, The Cohen Committee reported in 1945 that:

"there are no requirements as to the form of the profit and loss, or income and expenditure account, nor does the (1929) Act in terms make the auditor's report cover the profit and loss account; though since the balance on that account is necessarily carried into the balance sheet, an auditor cannot discharge his duties without examining it."

(para 97)

The Cohen Committee also reported that there were problems in interpreting s122 of the Companies Act 1929 which requires 'proper' books of account to be kept and the

defects in the wording of s134(1)(b) 'as shown by the books of the company' since a narrow literal interpretation may be a source of temptation to the weak auditor.

Also it should be noted that the present Bill has dropped the phrase 'true and correct' in view of the fact that 'true and correct' seemed to be one and the same thing. But the new phrase of 'true and fair' was not clarified much either under the Companies Acts and will require interpretation by the accountants then.

Lord Mancroft highlighted this problem in the House of Lords (Session 17 December 1946):

"I also particularly welcome the revision in the system of accounts whereby accounts must now be true and fair rather than true and correct as they previously had to be. It will be interesting to see how the accountants are going to tackle their new responsibilities in this respect."

(col 1040)

Nevertheless, the explanations given have provide some of the insights for the shift from a primary to a secondary duty to detect fraud; level 1b(s). This level continues to the present day.

7.5.3.8 SUB CONCLUSION

Over time, it seems that the company audit proved useful for economic growth and was politically used to encourage multiplication of ventures and assisting in the larger scale of enterprises for which technology and expanding markets supplied the prime dynamics. The inherent use of capital to beget constantly further capital provides a motive for the legitimation of the audit. Seen in this line, this power of the audit is a social necessity - it establishes a rule not only for the purpose of prosecution but for the purpose of exploitation of profit. These propositions are plausibly established by the large currents of events. Prime circumstantial evidence is the continued, increasing demands which businessmen made on statute law (via their political representatives) to supply them with the corporate governance of organisations.

Statute law is more often than not seen as the dependent variable, causally determined by the societal structure. But statute law, can of course, also be viewed as a more active instrument for shaping future behaviour and social forms. With the emergence of legislation as a major legal institution in common-law countries as well as on the

continent, in capitalist as well as in socialist states, it lies near at hand to view statute law as a vehicle of social engineering.

The legislators and those who carry out the precept of the law, set a process of influence into motion. A suggested aim is to modify and constrain the behaviour of the public, maybe even to mould their morals.

Others like Sumner (1940) claim that law can never shape morals, and that whatever correspondence is found between law and public attitudes and conduct is due to the fact that the law has been shaped by the mores.

In this section, the epiphanic shifts on the micro purposive graph were focussed on to offer some plausible sociological explanations on the emergence and variations of the auditor's statutory duties towards fraud detection. The turning points of change came about in the Joint Stock Companies Act 1844, Joint Stock Bank 1844, Joint Stock Companies Act 1856, Companies Acts 1879, 1900, 1907 and 1947. The concept of the epiphany is employed here to expose the structural (physical or metaphysical) variables which remains tacit and less readily observable but for the transformations taking place.

7.5.4 COMMENT

7.5.4.1 INFLUENCES ON LEGISLATION

In contemporary societies, the relationship between statute law and social change is of more than theoretical interest. In many countries, on matters as diverse as race relations and apartheid, the position of trade unions, the relative power of suppliers and consumers in a capitalistic market and the protection of the environment, statute law has been relied on as an instrument of important change. Yet statute law and legal institutions are constantly attacked and criticised because it is said that they are no longer in touch with, or relevant to a changing social world.

Statute law is certainly believed by governments to be a powerful instrument of change. In the UK, successive governments have used statute law and legal methods to canalise change and to introduce desired reforms, as in attempting to change patterns of child labour and sexual inequalities. In South Africa, statute law is being

seen as the prime means for improving the political and social position of blacks. Massell (1968) reported that law is frequently the chosen mechanism of revolutionary parties to extend the impact of their revolution into the social structure at large.

The problem of the relationship between statute law and social change is not a single one. The question is not: Does statute law change society? or Does social change alter statute law? Both statements may be, and more than likely are correct. Rather, we should ask under what specific circumstances can statute law change society, and to what extent, and vice-versa.

As was stated earlier, Parliamentary materials provide the source of all legislation. Allen (1964) wrote that the elements which contribute to the framing of much modern legislation are numerous and diverse. They are bound to be so in crowded communities where public opinion is not usually one collective and unanimous sentiment, but is fragmented among many different sectors and interests.

The following sections indicate the variety of strategies and countervailing pressures that emerge as audit legislation operates in a changing environment.

7.5.4.1.1 A PRODUCT OF CIRCUMSTANCES

Notwithstanding the range and diversity of its formative influences, audit legislation is a product of circumstances - social, political, economic, administrative - and of reactions to those circumstances in terms of which they are regarded as raising issues or constituting problems requiring action.

Take any example, say the Companies Act 1879. The immediate product of this Act was due to the catastrophic sudden collapse of the City of Glasgow Bank, precipitated by fraud. If one could naively but only temporarily relate the facts to the identified circumstances by treating them in isolation at the most basic level of understanding, one would say that the multi-million fraud of the century had a very wide social effect which has ruined so many families (Lord Denman, House of Lords, Session 14 August 1879 col 967). The question asked by the public at large was 'what went wrong?'. As the Act was formed out of a crisis, this was very much in line with the fire-fighting approach to legislation. The compulsory audit provision in the Joint Stock Companies Act 1844 and Companies Act 1900 also emerged as a result of the outright prevalence

of fraud. It seems that public's pressures for change in auditing regulation arise in part from attempts to pacify and satisfy expectations of corporate control in a world of global markets, multinational groups not easily susceptible to regulation by national agencies acting alone. Such pressures are particularly acute in the wake of visible regulatory 'failure', especially in the banking sector. In an important sense, scandal has been the moving force in the professionalisation of audit regulation, setting in motion waves of codification and institutionalisation in a panic Bill of Parliament. Taylor and Turley (1986) noted that a clear tendency may be discerned for legislation either to be framed in the immediate aftermath of a financial scandal or to lag behind an apparent need for change.

Politically, the alarm has opened Parliament's eyes to some defects and inconveniences in the (then) present law (Sir Stafford Northcote, House of Commons, Session 21 April 1879a col 791). The Government had to abandon their laissez faire politics and interfered with the management of the banks. With the imminent pressure from the public, the Government had to act quickly to allay the fears of the whole banking community and instil confidence in the wider society of the Government. It is seen as a panic Bill. With a national crisis like this, the credibility of the Government was called into question. It had to act swiftly to restore credit to the ruling political party (Sir Edward Colebroke, House of Commons, Session 29 July 1879 col 1552). The problem was to come up with a socially acceptable remedy to combat the mischief. As Finer (1966) observes of political parties:

"It will moderate all such special pleas to fit the contours of the party's temper, principles and philosophy; and above all, it will remember that the party exists to win elections."

(p20)

Then there is also the party and personal politics at bay.

Economically, the audit proposals had to be weighed, in terms of the costs and the benefits of acquiring the audit (Mr Lloyd, House of Commons, Session 21 April 1879 col 806). The issue raised was to what extent the audit will be fraud proof?

Administratively, the delicate task of deciding on the drafting of the scope of the audit had to be ironed out in both Houses. Issues of independence, qualifications of auditors, the wording of the audit report, the rights and duties of auditors have to sail through

the administrative Parliamentary stages from the First Reading to the Royal Assent stage. The problem lay in competing for the limited Parliamentary time available.

7.5.4.1.2 A PRODUCT OF PERSPECTIVES

Whether circumstances are regarded in this way depends on the perspectives of the groups or individuals in question (such as caveat emptor); their judgement of circumstances as requiring action constitutes a normative exercise conducted in terms of the group's or individual's values (such as laissez faire). Reactions may vary both horizontally, that is across groups, and vertically, that is through time.

Horizontally, not all groups may accept that the circumstances involved raise an issue or constitute a problem or, where they do, they may not agree on its nature or on what responses are appropriate.

Take for example, the Companies Act 1900. The Davey Committee and the Association of Trade Protection Societies were strongly for the recommendation of the audit in the light of the companies becoming bankrupt. On the other hand, the House of Lords in line with its laissez faire liberalism and caveat emptor philosophy saw that the circumstances of companies collapsing has more to do with the imprudence of management rather than fraud. Thus, it was not possible according to the House of Lords, to regulate to prevent the imprudence or incompetence of managers. This view was also shared by the House of Commons in the earlier Parliamentary stages. There appears to be a divide in opinion here between various groups (in the light of the circumstance of the companies collapsing) of whether an issue or problem existed. Even though subsequently, both Houses reverted to the Davey Committee's recommendations on the audit, they were not clear on what would be an appropriate response on the scope of the audit. Would the reinstated audit carry the responsibility for fraud detection? The final wording of the Act did not state explicitly for a fraud detection duty. There was a plea by Mr McArthur in the House of Commons (Session 26 June 1900 col 1168) to clarify the auditor's duties. Perhaps, it was left indeterminate and vague since both Houses may not have agreed on the full nature or scope of the audit.

Vertically over time, the similar circumstances may be regarded differently at different times and thus as meriting different responses; sometimes they even may be regarded as raising no issue or problem at all.

Lord Dudley noted in the House of Lords (Session 19 March 1896 col 1315) that about twenty years ago in 1877, the situation of fraud was so prevalent that though the Select Committee recommended further regulations, the Government did not act on the recommendations. Perhaps, they regarded it as raising no issue or problem at all then. But when the Davey Committee raised the same issue again in 1895, the Government took it up and proceeded with the recommendations to overcome the problem of fraud. If the laissez faire philosophy of the 1856 had continued to prevail, perhaps the audit would not have been reinstated. This response to the issue of fraud was perceived differently at different times throughout history by Parliament, varying from government interference through legislation to a self-regulation capacity through the contract in privity.

Given its control of access to the legislative process, the reaction of governments are all important. Unless a proposal elicits a favourable response from the Government, it stands little chance of reaching the statute book. As Rose (1984) observes:

"The process of law making is pre-eminently a political process. Social, economic and demographic influences may provide a stimulus to legislation. Nevertheless, the framers of legislation are in government, and no social or economic influence can be registered except in so far as it is mediated in the policy process."

(p24)

7.5.4.1.3 A PRODUCT OF SHARED FUNCTIONAL REPRESENTATION

Another issue is that much of the company law legislation initiated by the Government has been moulded by the unnecessary efforts of affected groups who can seek to imbue formal legislative initiatives with their own interests and ideas. While concentration on their role alone would in view of the control which government exercises over access to the legislative process and the preparation of legislation, present a highly misleading picture of the legislative process, their influence cannot be ignored. For after all, the existence and alteration of socially constructed structures (such as statute law) must in a sense always and everywhere depend upon the beliefs or feelings, or in other words upon the opinions of the society in which such 'structures' flourish.

Thus in practice, both government departments and political parties are heavily reliant upon affected groups for the identification of issues upon which legislation may be enacted; issues are not identified and policies are not formulated in isolation. In fact, the Government departments rely on groups affected by their policies for the identification of needed reforms, and proposals brought forward by departments may reflect the expressed needs of client groups.

This is manifested through the reports of ad hoc committees appointed to investigate an issue which may then give rise to Companies Acts legislation. During the early nineteenth century, Parliamentary Select Committees were commonly used for this purpose, eg Peel Report (1836), Select Committee Reports on Banks (1837-38), Gladstone Committee (1844). During the present century, the Select Committees have been effectively replaced by Departmental Committees under the appointment of the Board of Trade eg Davey Committee (1895), Warmington Committee (1906), Wrenbury Committee (1918), Greene Committee (1926), Cohen Committee (1945) and Jenkins Committee (1962).

Broadly speaking, these Committees may be charged with one or both of functions: the investigation of an issue, and the making of recommendations either independently of or pursuant to an investigation. Concentration on their overt function alone is, however, potentially misleading. Examination of the reasons underlying their use by Jennings (1957) reveals a negative as well as a positive side to their appointment. He observed that they were appointed by the Government to examine any question for which it cannot find, or does not want to find an immediate solution.

In carrying out its investigations, it has sought to amass a substantial amount of feedback and fact-finding from the affected groups. For example the Jenkins Committee (1962) consulted the Accepting Houses Committee, Issuing Houses Association, Association of British Chambers of Commerce, Association of Certified and Corporate Accountants, Association of International Accountants Ltd, Association of Investment Trusts, Association of Stock and Share Dealers, Association of Unit Trust Managers, British Insurance Association, Board of Trade, British Overseas Bankers Association, Chartered Institute of Secretaries, Committee of London Clearing Banks, Committee of Scottish Bank General Managers, Council of Associated Stock Exchanges, Council of Scottish Chambers of Commerce, Courtaulds Ltd, The

Economist, Faculty of Advocates, Federation of British Industries, General Council of British Shipping, General Council of the Bar, Institute of Actuaries, The Institute of Chartered Accountants in England and Wales and Scotland, Institute of Directors, Law Society, National Association of Trade Protection Societies, National Chamber of Trade, Registrar of Companies Court, Society of Investment Analysts, London Stock Exchange, Trade Indemnity Company Ltd, Trades Union Congress, Securities and Exchange Commission (USA), various companies, individual accounting firms and various prominent academics and practitioners.

How can one then explain for the greater likelihood of the varied group involvement in the preparation of legislation? Most commonly, it is attributed to a shared pluralist conception of authority on the part of the Government and outside interests. Beer (1982) attributes their greater involvement to the widespread acceptance of functional representation in British political culture.

Acceptance of functional representation has in turn meant that according to Smith (1976):

"It has now almost become a convention of the constitution that the interests likely to be affected by developments in public policy have, through their representative associations, a right to be consulted by policy makers...[and that governments] are regarded as having a corresponding duty to consult before taking final decisions."
(p56)

In the context of Companies Acts, these expectations as to the way in which public, including legislative power is being examined is as widely shared today as they were in the last century. Affected groups were normally consulted in all the Committee Reports studied. But even if they were not, there remain strong incentives for the Government to consult.

A failure to consult may make the passage of the legislation more difficult; more importantly, it may prejudice its successful implementation and thereby the attainment of the Government's objectives. The fact is that these groups, according to MacKintosh (1977) possess the capacity to limit, deflect and even frustrate the Government's initiatives. For this reason if none other, the Government seeks through consultation to arrive at an understanding with them beforehand.

Thus, benefits are derived from the shared involvement of these groups by both the groups themselves and the Government. For the groups, their involvement constitutes a procedural guarantee that their interests and views will be given a hearing, if not reflected in the content of the recommended proposals. For the Government, on the other hand, the groups' expertise and advice may be crucial to the formulation of workable proposals and their acquiescence, if not active co-operation, may be equally vital to the successful implementation of proposals. These groups are thus seen as important and necessary channels of communication which parallel representation through the electoral system. Without their activity, *Finer (1966)* observes, party rule would be a rigid and ignorant tyranny. Their privileged position in relation to the Government does however carry with it the danger that interests other than those immediately involved will be ignored.

The legal regulation of the auditor's duties is a matter fraught with difficulties. Consideration of this legal regulation presents two particular difficulties which may help to further explain why both case law and the legal literature in this are so scanty. The first is with the comprehensibility of the statute law which has been dealt with in s7.3.3 and 7.4.3.

The second point which is appropriately raised here is that relatively few members of the House of Lords or Commons have much understanding of the principles of auditing. If they generally do not understand the practices of the profession, then the law can do little other than accept the expert evidence and advice of the affected groups (eg members of the profession) as to what is acceptable practice.

Clokie and Robinson (1937) describes the work of such Consultative Committees as a notable example of the wise combination of fact-finding and policy-forming in the modern state. Such input is invaluable, bearing in mind, in the context of audit legislation, the majority of the House of Lords or Members of Parliament are not auditors or have a background in auditing. Given their essentially advisory nature of the Committees, this probably overestimates their significance in relation to the decision-making and legislative processes. Even where legislation is introduced that does not depart significantly from their recommendations, difficulties arise in attributing that legislation to their deliberations. At best they constitute one among a number of factors contributing to its enactment. What should not be ignored, however is their significance as a means of involving groups outside the Government in the decision-

making process, either through the inclusion of representatives of affected interests among their membership, or their dependence upon those interests for the evidence upon which their conclusions are based. As also noted by Cartright (1975), they provide a unique channel through which private individuals and interest groups can participate directly in the making of public policy.

So, the formal policy process of British Companies Acts' legislation is not carried out in a vacuum. Walkland (1968) also added that:

"The Departmental structure is increasingly characterised by an agency-clientele relationship with powerful organised interests; departments are usually wise to take note of the attitudes of those pressure groups, whose adherence to official policy is often vital to its success."

(p22)

When the draft Bill has been prepared it will have to go through the Parliamentary stages. What is presented to Parliament in the form of a Bill is as near to a finished product as it is possible to get within the time allotted to its preparation. What it lacks of course is the force of law, something which only the legislature can confer on it. The pre-Parliamentary stages are thus of great importance; it is during these stages that the main lines and content of the proposed legislation are hammered out, often in consultation with affected interests. Hence the frequently expressed view that all executive policy and most legislation is conceived, drafted and all but enacted in Whitehall (Devlin Commission, 1972).

7.5.4.1.4 A PRODUCT OF GOVERNMENT'S FREEDOM

But recommendations and feedback made by these Committees on Companies Acts legislation are usually but may not always be acted upon by the Government. Being advisory only, they do not restrict the Government's freedom in the formulation of policy, and the Government retains the same discretion in relation to the implementation of their recommendations as it does in relation to their appointment. So where legislation is introduced, it may depart from their recommendations. Thus for example, s33 of the draft Companies Bill 1900 (on auditor's duties) which was prepared and submitted by the Davey Committee in 1895 was substantially redrafted differently by the Government in the final version in s23 Companies Act 1900.

7.5.1.4.5 A PRODUCT OF THE DRAFTSMAN

However, there is also the draftsman whose function is more behind the scenes but nevertheless plays a vital role in the legislative process. The draftsman's function is to ensure that the Government's policies are given legal effect. Accordingly, a draftman's primary responsibility is to express the Government's intentions as accurately as possible in its legislation.

Acts of Parliament are legal documents. They state what the law is and how the lawfulness of acts purportedly in compliance with it is to be judged. Great care must therefore be exercised when formulating the factual situations and the propositions of law which are to apply to them. But more than that is that such formulations are unique in each Act, the draftsman has only one opportunity to get them right. Unlike some other forms of communication, the draftsman cannot convey his message on different occasions using different words. For in a statute, every word has legal significance and thus there is a premium on saying exactly what has to be said and no more.

Thus, the Government's intentions may be capable of being expressed with varying degrees of precision. For example, in the Companies Act 1900 the auditor's duty was restricted to 'the books of the company'. Whereas in the next Companies Act 1907, it was given more precision to 'the books of the company and information and explanations given'. Where they are capable of being stated precisely, and it is presumed the Government's wish that they be so stated for legal effectiveness, the draftsman is expected to ensure that there is as little opportunity as possible for interpreting the legislation in any way other than the Government's wishes.

But legal effectiveness does not necessarily imply legal certainty. Miers and Page (1990) observed that often the Government will want the statute to state precisely what the law is to be, but it is frequently not possible, and sometimes not desirable to do this. Government may wish to conceal the fact that it was unable to secure the agreement of groups affected by the legislation, to leave scope for compromises to be reached between those implementing the legislation and those subject to it, to obscure politically sensitive measures, or to reduce the opportunities to challenge the exercise of the powers conferred. It could be added that in so far as it is the Government's

intention to introduce uncertainty, the draftsman will have to give effect to it, even if the consequence is a reduction in clarity and precision.

7.5.4.1.6 A PRODUCT OF FORESEEABILITY

So far, the comments were on the process of tracing Companies Acts through the perspective of legal certainty back to the Parliamentary materials and other sources. Observations and comments can also be gathered if one were to reverse the process and start from the Parliamentary sources to the Companies Acts through the perspective of legal effectiveness.

In almost all cases, it is impossible for rule-makers to foresee every combination of circumstances to which their rules might apply. The 'relative ignorance of fact' in turn makes it difficult to define the exact scope of any proposed rule. For example, the auditor has to verify the 'assets' of a company under the Companies Acts. Does it mean 'financial' as opposed to 'real' assets? What about 'intangible' assets and 'investments'? Is an item an asset if it is not in use to generate a return on income or future earnings potential? To what extent is it the reversal of liabilities in the context of deferred or accrued earnings?

And even where rule-makers are well informed about the facts, they may be uncertain how to deal with them in particular instances. Hart (1961) terms this difficulty 'relative indeterminacy of aim'.

"It is a feature of the human predicament (and so of the legislative one) that we labour under two connected handicaps whenever we seek to regulate, unambiguously and in advance, some sphere of conduct by means of general standards to be used without further official direction on particular occasions. The first handicap is our relative ignorance of fact; the second is our relative indeterminacy of aim."

(p125)

Frequently these difficulties such as the scope of the audit are catered for by defining the activity or matter in question in broad terms, by reserving a power to make further rules by way of subordinate legislation or by conferring a discretion on a named authority, for example, the accountancy profession, the Department of Trade and Industry or possibly the judiciary to apply the rule in specific cases. The discretion may be qualified to a greater or lesser extent, for example by requiring that it be exercised reasonably. Nevertheless, the effectiveness in the application of these indeterminate

provisions may be progressively clarified through the development of precedents, administrative rule-making and the promulgation of subordinate legislation.

7.5.4.1.7 A PRODUCT OF LANGUAGE

Apart from ignorance of fact and indeterminacy of aim, there is another difficulty which affects the drafting of all rules, even where the policy makers and the draftsman are well informed about the circumstances to be provided for and have a clear conception of the scope of the rule. This difficulty is the inherent 'indeterminacy of language'. Rules by definition describe categories of the persons, things and events to which they apply. Companies Acts make maximal use of general classifying words like 'true and fair', 'correct', 'full and fair', 'audit', 'accounts', 'examine' etc. And when it is used in this way, language is as Hart (1961) pointed out, irreducibly open-textured. Even with the Definition Section in the Acts (where applicable), such classifying words may have a core of settled meaning and a penumbra where their meaning is indeterminate. The price to be paid for their use in legislation is uncertainty at the borderline.

What for example, is the scope of the word 'true and fair'? This legal phrase first appeared in the Companies Act 1947 affected the auditor's duties, especially with regards to fraud detection. However, no attempt was made to define it by the Act's draftsman. The meaning of the phrase is to say the least elusive and indeterminate and yet it is declared to be overriding, not withstanding the detailed provisions relating to the form and content of accounts. The layman often considers the phrase to have an absolute meaning, tantamount, perhaps to 'accurate' or 'exact', which makes the auditor liable for fraud in the certified accounts. As the statutory language used was so indeterminate, the (then) Accounting Standards Committee had to resort to Counsel's opinion on this. The joint opinion, by Hoffman and Arden (1983) was thus obtained with particular reference to the role of accounting standards but the opinion also considers the impact of 'true and fair' as a requirement of law and not merely as a compliance with SSAPs. Counsel's opinion was that it would not be wise to offer a definition but would be much more useful to illustrate the concept in action, for example to explain in specific cases, why certain accounts do or do not give a true and fair view.

These difficulties are inherent as long as written language is the tool for communicating the intention of Parliament in the Act; nevertheless it may be argued that their effect

could be lessened in a number of ways, such as the adoption of drafting techniques which place greater emphasis on making legislation more intelligible to the user, or the adoption by the judiciary of interpretive methods which place greater emphasis upon the purpose for which the legislation was enacted, ie the purposive approach.

The call for more explicit literal clarity on the Companies Acts and especially on the auditor's duties has been a constant resounding one by various affected groups and with it being evident by the minority protests in the Parliamentary Reports in the 1879 Bill, 1900 Bill, 1907 Bill, 1947 Bill and 1981 Bill. But the minority's murmur of complaint was hushed down quickly. This did lead to a varied interpretation of the audit service and its standards by the auditors and the affected groups. Pending on which mode of interpretation is adopted, this could easily lead to an expectation gap as the purposive graph is rather different from the literal or contextual graph. This gap would probably have been in existence from the previous century and not a late 20th century phenomenon as is believed, even though the term was only introduced this century.

7.5.4.1.8 A PRODUCT OF OTHER FACTORS

On the other hand, the failure to introduce legislation from the recommendations is not necessarily attributable to the Government's intention in not establishing them. Other factors such as cost, lack of Parliamentary time, opposition or the unacceptability of the proposals to the Government's policy of the day may influence the decision not to act. Nevertheless, their reports may be of longer term value in contributing to public awareness and in stimulating discussion of the issue. For example, the Davey Committee Report (1895) on fraud had its roots back in the earlier Select Committee Report in 1877 which advocated for further legislative actions but was not taken up then by the Government. But it did provide the subsequent development for the Davey Committee Report (1895) which reintroduced the compulsory audit.

7.5.4.1.9 SUB CONCLUSION

In this section, it was seen that legislation is a product of circumstances, perspectives, shared functional representation, the Government's freedom, the draftsman, foreseeability, language and other practical factors such as Parliamentary time.

The manner in which the particular audit legislation were passed varies in accordance with the degree of urgency attached to their enactment, their complexity and the likely political reaction to them; there appears to be no definite set pattern or due to an easily identifiable single product.

7.5.4.2 THE NOTION OF 'PURPOSE' OR 'INTENTION'

In the light of what has been said a priori about the notion of 'purpose' at the mini stage, it is necessary to ask what further sense can be given to the notion of 'the purpose or intention of Parliament'. The phrase is regularly used by the judges in statutory interpretation although it is meaningless unless it is recognised for what it is.

The word 'purpose' or 'intention' is used in a very different sense when it is said that, in passing a Companies Act, Parliament did or did not intend the Act to apply to all companies, did or did not intend the Act to apply to banks. Each of these statements can be used meaningfully although it is quite impossible to point to specific individuals, like the testator who did or did not entertain the intention in question in a will.

7.5.4.2.1 A UNIFORM CONSENSUS?

The 'intention of Parliament' with regard to a particular statute or provision within it cannot mean the intention of all those who were members of either House. Take for example, based on the Parliamentary debates on the Companies Bill 1900, Lord Dudley and Lord Halsbury (The Lord Chancellor) from the House of Lords and Mr Ritchie (President of the Board of Trade) and Mr Banbury from the House of Commons, were strongly against the reintroduction of the audit, even though the audit was finally made compulsory for all companies.

Or take the example of the view by Sir Stafford Cripps in the House of Commons (6 June 1947 col 597) that the 1947 Companies Bill in requiring more statutory disclosure of information will enable shareholders to exercise a more constant and intelligent control and hence minimise company failures. It was difficult to tell from Hansard to what extent the whole House of Commons felt about it. Did they whole-heartedly agree with him on this particular point, even the opposition Party?

Neither would it be the intention of all members of either House when the royal assent was given, for some of them might have been out of the country at all material times and never have heard of the statute.

Equally plainly, the phrase cannot mean the intention of the majority who voted for the statute as this will almost certainly have been constituted by different persons at different stages in the passage of the Bill, and in any event, it would be rash to assume that all those who voted for it, have the same intentions with regard to the particular section of the legislation. For example, in the Parliamentary debates (House of Commons) on the Companies Bill 1981, though both Viscount Caldecote and Mr Squire were in favour of the audit, Viscount Caldecote saw it in the context of small companies, whilst the latter saw it in the context of all companies.

7.5.4.2.2 AGENCY

Bell and Engle (1987) stated that anyone bent on identifying the intention of specific human beings as that to which reference is made when people speak of the intention of Parliament might resort to the notion of agency. It could be said that the promoters of a Bill must have some consequences in mind as its general and particular effects, but promoters whoever they may be, are initiators who place proposals before Parliament rather than act as its agents; and many Bills contain amendments which are not the work of the promoters. Nonetheless, if it were thought essential to regard the intention of Parliament as the same sort of thing as the intention of an individual legislator, or the intention of a number of individual legislators all of whom had in mind identical objects and effects of the statutes they jointly draft, the intention of the Members of Parliament who promote Parliamentary legislation would be the closest approximation. In modern times they give instructions to the draftsman and he can be regarded as their agent. To quote Lord Simon of Glaisdale in *Ealing LBC v Race Relations Board (1972) AC 342 at 360*.

"It is the duty of a Court so to interpret an Act of Parliament as to give effect to its intention. The Court sometimes asks itself what the draftsman must have intended. This is reasonable enough: the draftsman knows what is the intention of the legislative initiator; he knows what canons of construction will apply; and he will express himself in such a way as accordingly to give effect to the legislative intention. Parliament, of course, in enacting legislation assumes responsibility for the language of the draftsman. But the reality is that only a minority of legislators will attend the debates on the legislation."

It was also pointed out that not all members (legislators) participated in the debates and in either House, there will exist the silent backbenchers.

7.5.4.2.3 PARLIAMENTARY TIME

But then again, the inability of the majority of either House to participate in the debates can be partly due to the limited Parliamentary time available. If time is money, government might also say that it is legislation. It was difficult not to sense during the mini purposive stage in reading Hansard (especially the period covering the twentieth century) that a lot of the Company Bills were rushed through the Parliamentary stages. Although the House of Commons (1987) states that it sits for more days each year than any other comparable legislature and devotes the single greatest proportion of time to legislation, it is still faced with the fundamental problem of how to distribute the limited Parliamentary time available in such a way as to allow the Government the chance to enact its legislative programme, while at the same time preserving sufficient opportunities for the consideration of individual measures brought forward as part of that programme. Ilbert (1908) summarised the problem thus:

"On the one hand, how to find time within limited Parliamentary hours for disposing of the growing mass of business which devolves on the Government; and on the other hand, how to reconcile the legitimate demands of the Government with the legitimate rights of the minority, the despatch of business with the duties of Parliament as a grand inquest of the nation at which all public questions of real importance find opportunity for adequate discussion."

(pxxi)

It is with this conflict between the demands of the Government and the limited Parliamentary time that will affect the adequacy of the discussion on which the statutory purpose(s) is ascertained. Whilst the proportion of Parliamentary time spent on legislation has remained constant at approximately 50%, the volume of legislation has increased from approximately 200 pages a year at the beginning of the century (House of Commons, 1978) to about 3,200 pages in 1990. These figures take no account of the increase in the time spent on legislation off the floor of the House in standing committees, or of the increase in delegated legislation.

What, however of the conflicting need as Amery (1964) puts it, of the main task of Parliament to secure full discussion and ventilation of all matters, legislative or administrative, as the condition of giving its assent to Bills? Although the formal stages

of the legislative process have remained substantially unaltered since the last century, the sheer increase in the volume of legislation has undoubtedly meant that the consideration devoted to individual Bills has decreased, despite the concomitant increase in the time spent in standing committees. To a certain extent, Parliamentary consideration has been replaced by alternative modes of consideration. Despite the criticisms made of the drafting of legislation, Parliament has progressively made attempts to consult and negotiate with outside groups both before (esp via Green and White papers) and during the Parliamentary stages of the legislative process, with or without the assistance of MPs as intermediaries.

7.5.4.2.4 A POLITICAL PARTY'S PURPOSE

This latter development is perhaps one of the contributory factors to the contemporary sense of a decline in the importance of Parliament in the legislative process. While the historical accuracy of the view that during the nineteenth century MPs did participate effectively in the legislative process, it has been questioned by Walkland (1979) on the grounds that the Government's domination of the process itself and its product have been the subject of increasingly widespread criticism. Some of these criticisms such as those of the volumes of legislation enacted are perennial, others cannot be separated from the political content of individual proposals or are an inevitable consequence of the political context within which their consideration takes place. While some MPs want to play a greater part in the moulding of the legislative proposals, others treat their task as being no more than to support their own leadership when in office and to attack the other side when opposed as so captured by the TV cameras nowadays.

7.5.4.2.5 A MULTI-FACETED STATUTE

A further difficulty arises from the multifarious nature of statutes such as the Companies Acts. As mentioned earlier, one Act often deals with a multitude of subjects or purposes as evidenced in the long titles of most of the Companies Acts. For example, the long title for the classic Companies Act 1989 is as follows:

"An Act to amend the law relating to company accounts; to make new provision with respect to the persons eligible for appointment as company auditors; to amend the Companies Act 1985 and certain other enactments with respect to investigations and powers to obtain information and to confer new powers exercisable to assist overseas regulatory authorities; to make new provision with respect to the registration of company charges and otherwise to amend the law relating to companies; to amend the

Fair Trading Act 1973; to enable provision to be made for the payment of fees in connection with the exercise by the Secretary of State, the Director General of Fair Trading and the Monopolies and Mergers Commission of their functions under Part V of that Act; to make provision for safeguarding the operation of certain financial markets; to amend the Financial Services Act 1986; to enable provision to be made of the recording and transfer of title to securities without a written instrument; to amend the Company Directors Disqualification Act 1986, the Company Securities (Insider Dealing) Act 1985, the Policy Protection Act 1975 and the law relating to building societies, and for connected purposes."

Even when it is confined to a single subject or purpose, it may deal with many aspects within it. For example, the 1961 Companies Act's purpose is to empower Scottish companies to give security by way of floating charges. The Act dealt with powers, creation, effects, ranking and registration of such floating charges.

It is thus inept to speak of 'the purpose' of Acts such as the Companies Act. It is only possible to seek out the purpose of particular provisions and even when this has been done, it may be necessary to recognise that a single provision can have more than one purpose. As regards the provision for the statutory audit, this is clearly evident in having a secondary purpose besides the primary purpose for the Companies Acts in the years 1844, 1947, 1967, 1981, 1985, 1989. A pause is made here to note that the last six Companies Acts studied by tracing it back to the purpose established by Parliament, all pointed not explicitly, but only by implication, to fraud detection as a secondary purpose of the audit, and not the primary purpose as claimed to be by the public in the light of the recent fraud scandals such as BCCI, Ferranti and Barlow Clowes. The Parliamentary debates on the Companies Bill 1989 indicated that the audit was primarily to improve the reliability or credibility of the accounts (Lord Strathclyde, House of Lords, Session 16 January 1989a col 82). Another example lies in the 1844 Act of the audit provision. The primary purpose of the audit provision was to remedy mismanagement through indifference and carelessness (secondary mischief to the Act) which had made it more amenable for acts of fraud and illegality (primary mischief to the Act but secondary purpose of the audit). Hence a single statutory provision such as the audit can have more than one purpose.

7.5.4.2.6 IMPLICIT vs EXPLICIT

Moreover, the 'purpose' in the context of fraud detection could be directly ascertained (explicit level a) or indirectly concluded (implicit level b). By far, the majority of the conclusions (9 out of 15) were implicit conclusions. But there were explicit levels.

What this means is that the Parliamentary debates and other supporting historical documents may not be as vague in spelling out the intended statutory role of the auditor towards fraud detection in contrast with the literal and contextual stages where only an implicit level could be reached. The purposive methodology does seek to reinforce that determinacy and clarity where possible, from the Parliamentary materials.

Lord Watson in *Saloman v Saloman & Co Ltd (1897) AC 22 at 36* stated that:

"Intention of the legislature is a common but very slippery phrase, which popularly understood, may signify anything from intention embodied in positive enactment to speculative opinion as to what the legislature probably would have meant..."

In contrast, here in the purposive stage, one is trying to make the intention less 'slippery' or 'speculative' by systematically and rigourously examining the Parliamentary Debates to reach a more explicit conclusion.

7.5.4.2.7 SUB CONCLUSION

The notion of 'purpose' or 'intention' of Parliament is not one of absolute consensus between and within the members of either House. It might be helpful to see it in terms of agency due to the constraints (such as Parliamentary time, political ideologies, multi-faceted statutes) which restricts the development towards a uniform consensus.

Hence, to talk of the 'purpose' or 'intention' of the statute or statutory provision per se is to run the risk of thinking that every statute or statutory provision has a single, discoverable and unequivocal purpose.

7.5.5 CONCLUSION

The micro purposive stage has sought to provide some explanations for the epiphanic shifts and to offer some interpretive insights emerging through those explanations.

The purposive approach has helped to make the 'indeterminate' statutory provisions a bit more explicit and meaningful in terms of ascertaining the intention of Parliament and the mischief it sought to remedy. Nevertheless, the difficulty is the laborious search required by the apparently endless pages of Parliamentary materials.

7.6 THE MICRO JUDICIAL STAGE

7.6.1 MICRO JUDICIAL GRAPH

The coded mini judicial definitional interpretations are now translated onto the constructed graph as shown in Figure 7·7. It shows the year the judge's decision was given, indicated by a cross with a circle; both the auditor's and the other counsel's interpretation of the respective Companies Acts, indicated by a cross and the symbols A and C respectively. The particular Companies Act referred to in the case is indicated by the respective vertical arrows on the graph.

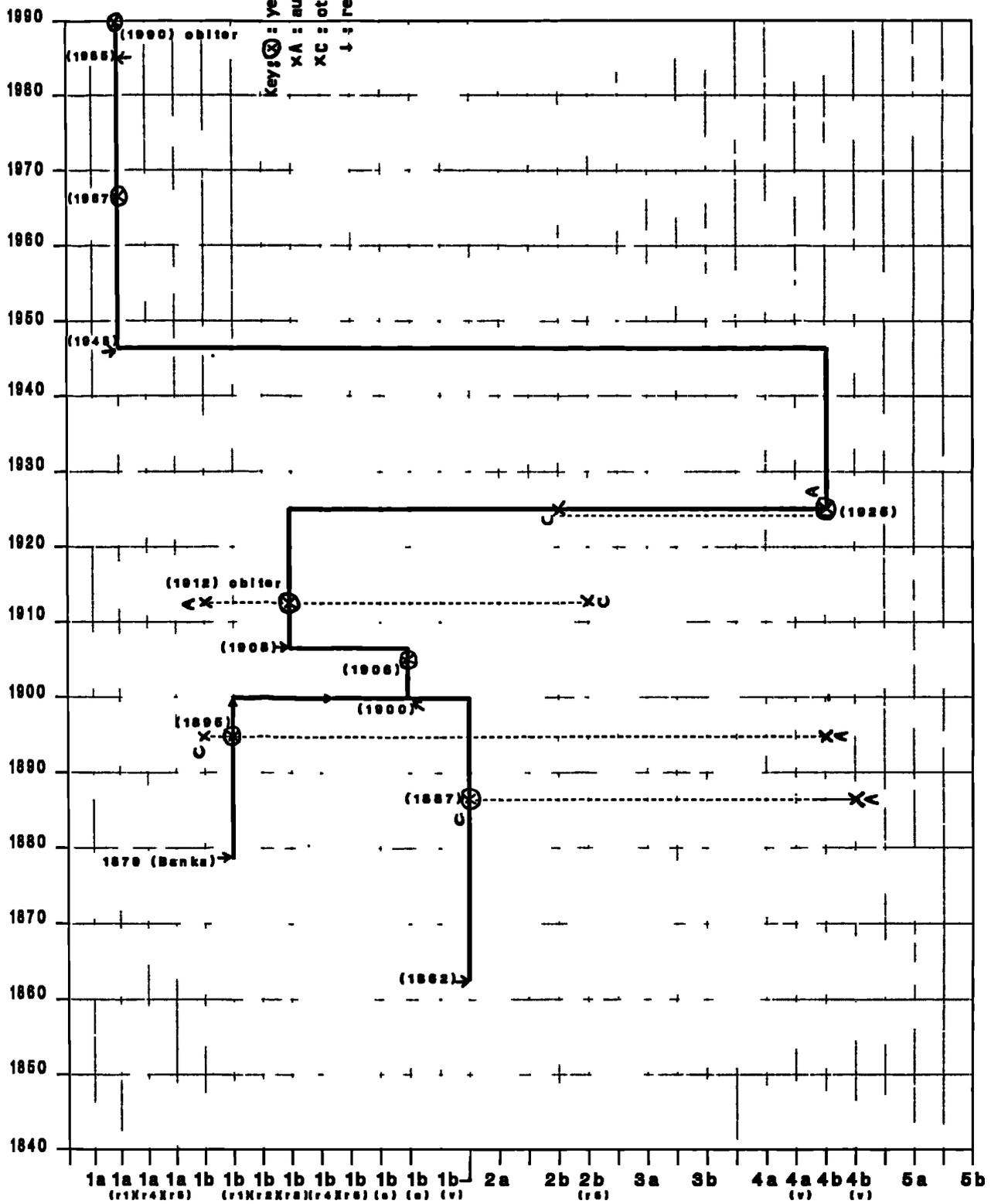
7.6.2 OBSERVATION

The judicial graph seems to resonate around level 1 (creation of statutory duties) except for the short dip to level 4b (implied contractual duty) during 1925-1947. It starts on level 1b(v) for the 1862 Act and continues to 1900. Meanwhile, the Companies Act 1879 which affected banking audits emerged on level 1b(r₁) but merged with all companies on level 1b(o) in 1900 till 1907 when it rose to level 1b(r₃). The *City Equitable (1925)* case moved it further down to level 4b where it stayed until 1947 and resurfaced at level 1a(r₁) which continued into the present day.

What this means is that judges in general expect the auditor to adopt some statutory duty to detect fraud based on the Companies Acts. It seems that statute law and case law are directly integrated so far as the legal meaning of certain words is concerned. As was mentioned earlier, most words affecting the auditor's duties (eg true and correct) have not got a specific legal meaning. In the absence of good reason to the contrary, the Courts then give effect to the ordinary meaning of the words used in a statute. In any event, the Courts are more often than not concerned with the effect of whole phrases and sentences in a particular context rather than with that of a single word.

For example, in the *Newton (1906)* case, Justice Buckley interpreted 'true and correct' as equivalent to 'accuracy'. He did not split the phrase into two separate single words or interpret them separately. Where reference to the relevant specific whole phrases were not made, as is more commonly the case, then in their judgement, reference to the whole sentence or section of the Act is given. In the *City Equitable (1925)* case,

Figure 7-7 :
MICRO JUDICIAL GRAPH



Graph reads this way

Lord Justice Warrington proceeded to expound on the auditor's duties by reference to s133 as a whole provision rather than breaking it up into fragments of single words for analysis.

7.6.3 COMMENT

7.6.3.1 JUDICIAL APPLICATION

When interpreting statutes, the Courts often announce that they are trying to discover 'the intention of the legislature'. In actual fact, if a Court finds it hard to know whether a particular situation comes within the words of a statute or not, the probability is that the situation was not foreseen by the legislature, so that the Lords and Members of Parliament would be just as puzzled by it as the judges are.

Take for example, the *Leeds Estate (1887)* case. Here, the Articles of Association of the investment company with regards to the auditor's duties were adopted as under the Companies Act 1862. Part of the judgement given hinges on what is meant by a 'true and correct' view of the balance sheet. Does it mean arithmetical accuracy (ie the balance sheet represented and was a true translation of what appeared in the books of the company being the argument forwarded by counsel for the auditor) or does it mean substantial accuracy (ie the balance sheet was free from errors, innocent or fraudulent and not merely a correct representation of what appears in the books as forwarded by the other counsel)?

In the first place, without referring to the travaux preparatoires, the Court will either have to resort to the Definition Section of the Act or the Interpretation Act of 1850. But both sources are silent on the meaning of this legal phrase. The Court will have found it hard to ascertain solely from the two counsel's argument the intention of the legislature which comes within the words of the Companies Act of 1862.

In the second place, even if the purposive approach was resorted to (which was not), where Parliamentary materials were examined, it was found that Parliament had not addressed this situation in their debates. Hence they could be as puzzled by it as the judge would be if the facts of this case were put before them.

But a judgement had to be made in the Court. The judge concluded by his own reasoning what he thought it meant by saying:

"It was in my opinion the duty of the auditor not to confine himself merely to the task of verifying the arithmetical accuracy of the balance sheet but to inquire into its substantial accuracy, and to ascertain that it contained the particulars specified in the Articles of Association (and consequently a proper income and expenditure account) and was properly drawn up, so as to contain a true and correct representation of the state of the company's affairs...the duties of the auditor were not in reality discharged by him."

(36 Ch D 802-3)

7.6.3.1.1 INTENTION OF PARLIAMENT - A MYTH?

Here the question raised is whether the intention of the legislature is a fiction. Because of the various difficulties, it can be denied that the Courts are really concerned with the intention of Parliament. Lord Simon in *Farrell v Alexander (1977) AC 59 at 81* said:

"In the construction of written documents including statutes, what the Court is concerned to ascertain is, not what the promulgators of the instruments meant to say, but the meaning of what they have said."

The other judge, Lord Edmund-Davies, thought it proper to speak of the intention of Parliament, in the sense of the meaning which Parliament must have intended the words to convey. In case of doubt, the Court has to guess what meaning Parliament would have picked on if it had thought of the point. The intention applied in this way is not actual but hypothetical. There is a limit to what a Court can do by way of filling out a statute, but to some extent this is possible.

In *Black-Clawson (1975) AC 591 at 613*, Lord Reid said:

"We often say that we are looking for the intention of Parliament, but that is not quite accurate. We are seeking the meaning of the words which Parliament used. We are seeking not what Parliament meant but the true meaning of what they said."

The remark is somewhat cryptic, but from the judicial point of view, the intention to be attributed to the legislator is to be determined from the 'objective' words used, rather than from any 'subjective' intentions which were not expressed in the text. All the same, the remark suggests a distinction which is not that obvious, because in ordinary language, when in doubt, one must do one's best to make sense of what the author

said in the context appropriate to his speaking, which requires some knowledge of the author, the background and what he was trying to say.

However, if the intention or purpose of Parliament is not to be a dominant ingredient in judicial interpretation, it might be better understood to say that it is the process by which the Courts determine the meaning of a statutory provision for the purpose of applying it to the situation before them. That determination of meaning by a judge trying a case on a statutory provision for the purpose of applying it to a given situation will be dependent on their views of what the Courts have done in similar situations or would do in the situation if it were to come before a higher Court.

It is in the latter point of what the Courts would do that is of concern here. Though the Court's primary task here is the interpretation of the meaning in a particular case of the abstract language of legislation and in view of it being non-purposive, one wonders if the Courts adapt the even more abstract language of the 'society's ideals' in which their very existence is sanctioned.

7.6.3.1.2 FRINGE MEANINGS

An illustration is the common legal problem of 'fringe meanings'. Words in general though they have a central core of meaning that is relatively fixed, have a fringe of uncertainty when applied to the infinitely variable facts of experience. For example, auditors are required to verify 'plant' as in 'plant and machinery' but a judge may not find it easy to decide whether concrete grain silos, office partitioning, lighting, free standing decorative screens is a 'plant'. There is no statutory definition of 'plant'. Case law therefore becomes important.

7.6.3.1.3 MEANING vs FACTS

It appears that from the cases examined involving statute law, (in this context, the Companies Acts) the Courts are faced with two procedures which is not always made explicit in the Law Reports, namely to ascertain the meaning of the statutory words and to ascertain the actual facts of the case. The table (Figure 7'8) below summarises the demarcation outlined above. Where the words and facts only are undisputed, then it is a straightforward 'application' of the precedent if there is one. But where the facts only are disputed, then the focus of the Courts will be on 'rectifying' the disputed facts.

Thus, the word 'interpretation' is only apt in its reference to statutes in the judiciary context when there is doubt or dispute about the meaning of the statutory words and not so much the facts.

Figure 7'8 : FOCUS OF COURTS IN VARIOUS CONTINGENCIES

Doubt Factors	Disputed Statutory Meaning	Undisputed Statutory Meaning
Disputed Facts	Interpretation and Rectification	Rectification
Undisputed Facts	Interpretation	Application

But even then if one has provided some insight into the boundaries of judicial interpretation, Bentham (1970) goes on to say that a liberal interpretation (whether extensive or restrictive) is actually crossing the boundary into 'alteration'. An extensive interpretation applies a statutory provision to a case which does not fall within its words when literally construed. Restrictive interpretation fails to apply a statutory provision to a case which does fall within its words when literally construed. He argues:

"In either case thus, to interpret a law is to alter it: interpretation being put by a sort of euphemism for alteration. Now to extend on old law is in fact to establish a new law, as on the other hand to qualify the old law is pro tanto to destroy it."

(p163-4)

Was Bentham's perception right? It is said that the Courts in theory have no power to amend the statute, although they may read in words which it can be inferred that the legislature meant to insert. As Driedger (1983) puts it:

"It is one thing to put in or take out words to express more clearly what the legislature did say, or must from its own words be presumed to have said by implication, it is quite another matter to amend a statute to make it say something it does not say, or to make it say what it is conjectured that the legislature could have said or would have said if a particular situation had been before it."

(p101)

However, it is not easy to distinguish between cases in which an interpreter is 'liberal' in Bentham's sense of attributing to the legislator an intention with regard to a particular situation which he plainly did not entertain, and cases where an interpretation attributes to the legislator's words a restricted or extended meaning on account of an intention which he was believed to entertain.

But with the aid of the purposive graph, when it is juxtaposed with the judicial graph, it shows that in practice, the Courts possibly offered 'altered' meanings since there was not a single point where the Court's judgement matched with the Parliament's intention. Whatever rule of interpretation the judge is adopting, there seems to be scope for 'alteration'.

The foregoing points illustrate a feasible danger that if the statutory words are construed broadly, without the aid of the purposive approach, then perhaps another word for such judicial interpretation is really alteration in its subtle form.

7.6.3.1.4 INTERPRETER OR LEGISLATOR?

In problems like this, the process of interpretation is indistinguishable from legislation: the judge is whether he likes it or not, a legislator. For if he decides that the concrete grain silos is a 'plant' and not a 'building' [*Schofield v R&H Hall (1974) 49 TC 538 CA (W)*], he is in effect adding an interpretation clause to the statute which gives 'plant' an extended application. Whereas if he decides that the concrete grain silos is not a 'plant', he adds a clause to the statute which gives it a narrower meaning.

The words of the statute, as they stand, do not give an answer to the question before the judge; and the question is therefore legislative rather than interpretive. This simple truth is rarely perceived or admitted: the judge could appear or pretend to get his solution out of the words of the Act, though he may assert in so doing to be guided by its general policy. This kind of 'interpretation' may be legally and socially sound although it reaches results that could possibly surprise the draftsman.

Hence, it has actually been held that lighting in a department store could not be treated as 'plant' [*Cole Brothers v Phillips (1982) 2 ALL ER 247*]. Whereas free standing decorative screens installed in the windows of a branch of a building society did qualify as 'plant' [*Leeds Permanent Building Society v Proctor (1982) 3 ALL ER 925*].

7.6.3.1.5 SUB CONCLUSION

The Court's primary input into the legal system, being non purposive, appears to be a deception of the ideal state of affairs in which they are to carry out the Parliamentary purpose of the enactment. The immediate corresponding output of the judiciary is the application of general policy statements to the specific conflict at hand. This, of course, means that the Courts can by no means be passive or mechanical implementers of the legislative policy; the statute must be implemented, and its implementation is a creative art, giving real effect to the abstract language of the legislature. Thus irrespective of whether one sees the judge as an interpreter or legislator or alterator, the Courts are an indispensable adjunct to the legislative exercise of power. In return for the output of 'interpretation', the Courts receive from the State a secondary input, the sanction of enforcement. Judicial decisions become binding on the litigants through the power of the State which includes the concept of enforcement - it is by the legislature that the Courts are empowered to resolve disputes and are given the facilities for doing so: courthouses, judgeships, salaries and so on.

This section has highlighted under judicial application that the 'intention of Parliament' so commonly expressed in the Courts is really a myth, as the judiciary system is non-purposive. The problem confronting the judiciary is further exacerbated by the problem of fringe meanings, disputed facts and opened statutory meanings. Nevertheless, at the end of the day, the judge is perceived to be more as a legislator than an interpreter.

7.6.3.2 JUDICIAL CHARACTERISTICS

Judicial interpretation comprises only a very small proportion of the countless occasions on which statutory provisions are daily applied in our everyday life to particular sets of circumstances. Nevertheless, it displays five characteristics which give it a significance setting it apart from all the other canons of interpretation. It is formally authoritative, becomes binding precedent, claims to be disinterested, is non-purposive and finally is ex-post.

7.6.3.2.1 AUTHORITATIVE

Thus, leaving aside the possibility of further legislative intervention, the answer that a Court reaches concerning the propositional or semantic question posed has by definition

legal priority over all other (literal, contextual, purposive) interpretations. A Court's interpretation has therefore a legally compelling quality which may be enforced by those having an interest in its subject matter.

Interpreters in general are, as an inescapable feature of intellectual life 'constrained' in the directions in which they may advance new interpretations. There can, according to this feature of authority, be no such thing as a 'free for all' in interpretation, since any interpretation that is legitimised is one which the relevant actors (judges, barristers, legal counsel) have already acknowledged as final. These actors comprise the interpretive community whose standards define what counts as an authoritative interpretation.

But where there is judicial silence, the views of professional advisers may then in practice constitute a temporary and authoritative interpretation of a statutory provision. This might explain partly why during the intervening period between the *Thomas Gerrard (1967)* case and the *Caparo Industries (1990)* case, there were much efforts by the accountancy profession to issue professional guidance on this matter of fraud detection. Gower (1982) argues that:

"Although we like to pretend that only Parliament and judges make law, the fact is that the legal and accountancy professions, by their interpretation or misinterpretation of it and by their practices and standards, do so too. So much so that when these occasional misinterpretations are exposed by the judiciary, the legislature may step in and whitewash them."

(p47-49)

What this also implies is that even if the professional guidance absolves the auditor from any duty to detect fraud, if and when the judiciary steps in for such a duty, the professional stand is 'whitewashed'.

7.6.3.2.2 BINDING PRECEDENT

Secondly, a judicial interpretation of statutory words is that decisions with regard to them, unlike other decisions on questions of fact, become binding precedents so far as the construction of the statute in question is concerned. As Kerr L J remarked in *R v London Transport Executive, ex parte Greater London Council (1983) QB 484 at 490*:

"The interpretation of the intention of Parliament as expressed in our statutes is a matter for the Courts. Once the meaning of an Act of Parliament has been

authoritatively interpreted, at any rate by the Judicial Committee of the House of Lords as our highest tribunal, that interpretation is the law, unless and until it is thereafter changed by Parliament."

The role of judicial precedent was very pronounced and explicit in the judges summing up of the cases examined, so much so that in applying the law, the explicit focus of the judges has been on the ratio of earlier cases rather than interpreting on specifically the actual statutory words used.

For example in the *Thomas Gerrard (1967)* case, the High Court judge in interpreting s162(1) CA 1948, sought for guidance in the previous higher Court of Appeal ratio in the *London and General Bank (1895)* case rather than basing the interpretation solely on the statutory words per se. Similarly, in the *Caparo Industries (1990)* case, even though it is obiter, the Court of Appeal referred to the earlier Court of Appeal's ratio in the *London and General Bank (1895)* for guidance. This is in spite of the lengthy provisions provided by the Companies Act 1985 on the auditor's duties.

However, while a judicial decision may count as a precedent on the interpretation of the statute in question, it may not necessarily be binding for the interpretation of a consolidating statute which subsequently enacts the provision, unless the wording is unaltered.

But it should be pointed out that precedent is subordinate to legislation as a source of law in the sense that a statute can always abrogate the effect of a judicial decision. No Court is entitled to substitute its words for the words of an Act. That means that the words used by the Court are not to be treated as if they were words in an Act of Parliament. Cross and Harris (1991) observed that the Courts regard themselves as bound to give effect to legislation once they are satisfied it was duly enacted.

As highlighted earlier, the pervasive force of binding precedent was very much evident in the proceedings throughout the cases examined. How did this self-imposed principle of stare decisis reach such a level of judicial acceptance?

Stability in the law is perhaps a major explanation claimed for the doctrine of judicial precedent. If a case was decided in a particular way in 1991 by a higher Court (eg Court of Appeal or House of Lords), the doctrine of stare decisis would normally demand that a Court in 1995 faced with the same problem as in the previous case

should decide it in the same way, assuming there are no changes in the statutory regulations.

In the interests of justice, it would be unfair to reach a different decision the next day a similar case crops up. This is one of the objections to the prospective overruling of cases but retrospective overruling is also affected by it. Prospective overruling means that the overruled case is applied in the instant case and is inapplicable in future cases only. Retrospective overruling means that the overruled case is regarded as never having been law and will not be applied either in later cases or in the instant case. So the overruling of an earlier case may cause injustice to those who have ordered their affairs in reliance on it.

It is partly to prevent this sort of injustice that the Court of Appeal must normally adhere to its own previous decision and the House of Lords should be circumspect in departing from its previous decisions. The problem with this is that the application of precedent may produce justice in the individual case but injustice in the generality of cases. It would be undesirable to treat a number of plaintiffs unjustly simply because one binding case had laid down an unjust rule. That appears to be a major criticism of stare decisis.

But the existence of precedent may prevent a judge making a mistake which he might have made if he had been left on his own without any guidance. It may also allow persons generally to order their affairs and come to settlements with a certain amount of confidence. But such advantage of stability is lost where there are too many cases or they are too confusing. This can arise through the process of distinguishing cases and over-refining the principles embodied in them. Stability in the law can only result from a large body of case law if the cases are uniform in outcome and not irreconcilable.

From a resource viewpoint, the following of precedent serves as a convenient time-saving device. If a problem has already arisen and been solved in a certain way, it is natural and effective to reach the same conclusion on the same problem without too much reconsideration. All legal systems follow precedent to a greater or lesser extent. The English legal system differs from most of the others in that it has a doctrine of binding precedent.

But it must be remembered that decided cases are illustrations of principles of law which a judge may turn to in deciding the case before him. Precedents, as pointed out by Lord Macmillan in *Birch v Brown (1931) AC 605 at 631* should be used as 'stepping-stones' rather than as 'halting-places'. The convenience of following precedent could degenerate into a mere mechanical exercise performed without any thought.

Still, there is the presupposition that a judge should be free in flexibility to lay down whatever interpretation he considers desirable in order to keep the law in step with changing social and economic conditions. But a judge is not thus free where there is a binding precedent.

For example, Freedman and Power (1991) commented that the decision of the Courts in the *Caparo Industries (1990)* case is not in tune with the needs of the market. The case seems to have shaken the accounting and business world, holding that auditors owed no duty of care to the public at large who relied on audited accounts to buy shares or even to existing shareholders in the company considering the purchase of further shares. So there was some initial relief amongst auditors that their liability was to be limited by judgement but to others it seemed that their role was threatened. It is now more generally perceived that the decision though superficially beneficial to the profession has actually done the auditors a disservice (Waller, 1991). It is certainly arguable that audited accounts have a function even though they can be relied upon only by a narrow group of persons, but what has shaken public confidence is the gap between the rhetoric of the regulators and company law purporting to protect investors at large and the reality. There thus seems to be a gap between the principle and practice of company control.

The Committee on Corporate Governance (1991) commented that in a moving situation, best practice has to give the lead; regulation may or may not follow in its wake, but it cannot make the pace.

It seems that the cumbersome legislative and judicial processes are regarded as part of the problem rather than the cure. If company regulation in its widest sense via the impact of case law decision is generally seen to be as irrelevant to current problems relating to the auditor's role, as the *Caparo Industries (1990)* case suggests, then a thorough rethink may be called for.

Unless a case can be distinguished, the judge must follow it, even though he dislikes it or considers it bad law. His discretion is thereby limited and the alleged freedom becomes rigidity. Judicial mistakes of the past are perpetuated unless bad decisions happen to come before the House of Lords for reconsideration. In any event, the freedom of flexibility and stability are incompatible features of judge-made law. A system that is truly free and flexible cannot at the same time be stable because no one can predict when and how legal development will take place.

So too, the citation of authority in Courts are normally kept within reasonable bounds because it can be costly in terms of time and money. Lord Diplock has warned of the danger of so blinding the Court with case law that it has *"difficulty in seeing the wood of legal principle for the trees of paraphrase"* [*Lambert v Lewis (1981) 1 All ER 1185 at 1189-90*].

The doctrine of stare decisis is a limiting factor in the development of judge-made law. Case law is founded on experience but the scope for further experience is restricted if the first case is binding.

Nevertheless the interpretation of statute law in decided cases offers opportunities for growth and legal development which could not be provided as easily by Parliament. The Courts can more quickly lay down new principles or extend old principles, through interpretation to meet novel circumstances.

7.6.3.2.3 DISINTERESTEDNESS

Thirdly, judicial interpretation is in theory impartial. By his oath on s4 Promissory Oaths Act 1868, a judge is bound to do right to all manner of people after the laws and usages of this realm. For in order to perform its functions, the judiciary system needs a willingness on the part of potential litigants to use the Court as a conflict-resolving mechanism. People must be motivated to turn to the Court for protection of their interests, and this implies that they must feel that the Courts will in fact give them justice. It is thus in the offer of 'justice' that the legal system makes its major output in exchange for the input of motivations to accept the Court as a problem-solving structure. This means that a judge is expected to interpret statutory provisions from a position of disinterestedness and unbiasedness, in contrast with the counsel's position.

Legal counsel in representing their clients appear to endeavour to reach an interpretation which satisfies at least two potentially conflicting conditions; first, that it should, where possible, be favourable to their clients' interest and secondly, that it should, if challenged by a Court of law, receive judicial approval.

It was found that in the four cases examined which reported on counsel's interpretation, three of the auditor's counsel [in the *Leeds Estate (1887)* case, *London & General Bank (1895)* case, *City Equitable (1925)* case] had a downward swing to level 4b, for a lower duty of responsibility (in the auditor's favour) when representing them. The remaining *1912 Cuff* case dealt with the fraud detection issue in obiter and hence there was less onus to argue for a lower duty. Similarly the other counsel in the law suit appears generally to argue in the opposite direction for a higher duty to detect fraud.

There seems to be some bias by both counsel in their statutory interpretation which seeks to favour their clients' interest first and foremost. But although a legal adviser or counsel will seek an interpretation which best serves his or her client's interests, s/he will have to reconcile this with the need to seek an interpretation which would appeal to a disinterested judge.

7.6.3.2.4 NON-PURPOSIVE

There is a fourth reason, not directly connected with the meaning of words, why judicial interpretation is of significance in relation to statutory interpretation. The Courts' powers of investigating the purpose of a statute are restricted by the fact that there are certain types of evidence, such as Parliamentary debates, which may not be considered. What Lord Denning said in *Escoigne Properties Ltd v IRC (1958) AC 549 at 566* still holds today.

"In this country we do not refer to the legislative history of an enactment as they do in the United States of America. We do not look at the explanatory memoranda which preface the Bills before Parliament. We do not have recourse to the pages of Hansard. All that the Courts can do is to take judicial notice of the previous state of law and of other matters generally known to well-informed people."

Freedman and Power (1991) commented that the judgements in the *Caparo Industries (1990)* case revealed a certain puzzlement amongst their Lordships as to the objectives

of the statutory audit. This ought not to come as a surprise, since the statutory provisions were not clear and the judicial view is non-purposive.

Rather the case law interpretations and decisions by the judges appear to form part of a more general movement to contain the tort of negligence. Cases confronting the Courts on the auditors statutory 'failure' to detect fraud were tackled by the judiciary system from the angle of negligence and what is reasonable care and skill, rather than what was the Parliamentary's purpose of having a statutory audit.

At the same time, case law has interacted with the difficulties at the root of company law to reveal a failure of in defining and comprehending the legal model of the audit and the role of auditors within corporate governance and fraud detection. The decisions in case law have been expressedly and unashamedly pragmatic rather than logically purposive. If case law is seen as setting the Parliamentary policy decisions 'in practice', then the lengthy discussion and fuelled debates on the purpose of the statutory audit in Parliament seems somewhat defunct and meaningless.

And case law has not only left this function of the audit unclear but they have failed to spell out the precise limits of the duty owed to different classes of persons in different circumstances. In more recent periods, the profession has to respond in the form of Auditing Guidelines and other pronouncements to fill in this gap.

7.6.3.2.5 EX-POST

Fifthly, judicial interpretation is practical in character since it is based on the interpretations of actual statutory provisions having brought before the Courts rather than on logic or theory. In this respect, judicial interpretation differs from the earlier interpretations (eg literal) which is based on the a priori interpretation.

Thus where there is a conflict or variety of possible coded levels that the auditor could come under due to the different canons of interpretation, once the Court has decided on it, the judiciary view stands. This means that the judiciary rule 'dominates' the other canons of statutory interpretation. But as seen on the micro judicial graph, there were only 4 cases brought to the Courts over a span of nearly 150 years. It does not seem a popular resort to clarify the statutory duties.

7.6.3.3 LEGAL EFFECTIVENESS

It is possibly due to these characteristics that Parliament would expect the draftsman to draft legislation which is legally effective. This means that where statute is challenged in judicial proceedings, there will be as little opportunity as possible for it to be interpreted in any other way other than as Parliament intended. Should it come before a Court, the key issue is whether the disputed section bears the meaning which Parliament intended it to have . If a disinterested judge arrives at the same interpretation of the section as that placed upon it by the interested parties, the draftsman has done what was required of him or her.

Using the *London and General Bank (1895)* case, the legal effectiveness of the draftsman is put into some doubt. The intention of Parliament, on the basis of the purposive approach indicates a fraud detection duty restricted to the books (ie level 1b(r₅)) whereas the judges interpretation was a slightly different duty to be restricted by reasonable care and skill with suspicions being aroused [ie level 1b(r₁)]. Both counsel also arrived at different interpretations, namely levels 1b and 4b.

For the auditors and clients in opposition, whether or not in a law-suit, judicial interpretation provides the acid-test to their own interpretations of a statutory provision. To this end they will attempt to forecast what a Court would decide, and sometimes treat action against them as offering the opportunity to clarify the scope of their powers and duties. The costs to an auditor or a client of a decision contrary to its own interpretations may be quite devastating to the losing party, the auditing profession and third parties.

This can be illustrated by the *London and General Bank (1895)* case. Here counsel for the auditor stated firmly at the start of the defence that it has never yet been decided what is the exact character, nature and extent of the duties of the auditor. He then proceeded to offer his (ie the auditor's) interpretation that as auditors are not always on the spot to manage the company, he must accept the books (even if they are fraudulently prepared) as he finds them. He argued that it is a fallacy to contend that the auditor has a duty to check the directors and by implication detect fraud. Counsel's interpretation was that such a duty is to be arranged between the parties in the contract (ie level 4b).

In contrast, counsel of the other party at suit argued that the auditor is not to accept the books as he finds them nor is it sufficient to verify the correctness of the entries in the books but to protect the shareholders from being deceived by the directors. The interpretation by counsel here was in favour of an implicit duty to detect fraud at level 1b.

In the light of such a vast expanse of interpretations between the two counsel, the judicial interpretation of s7 CA 1879 thus provides the acid-test for their own interpretations and also for clarifying the possible ambiguity of the statutory wordings. Interesting enough, the judge did not conclude at the purposive level nor agreed with either counsel's interpretation but offered his interpretation at level 1b(r₁), based on the reasonableness test.

The cost to the auditor was devastating as he had to make good (in joint liability with the directors) to the official liquidator of the bank two sizeable sums of 5946 l 12s and 8496 l 11s, being respectively, the amounts of the dividends paid in those two years. Counsel for the auditor protested that this is the first time that any attempt has ever been made to fix an auditor with such liability towards damages.

As this is decided in the Court of Appeal, it does lay down a precedent for itself and lower Courts in subsequent case hearings in the *Newton (1906)* case, *City Equitable (1925)* case, *Thomas Gerrard (1967)* case and the *Caparo Industries (1990)* case.

7.6.4 SUB CONCLUSION

Judicial interpretation, therefore, casts a long shadow over the interpretation of statutes generally. In the absence of further statutory definition in the present legal system, a judicial decision becomes the definitive answer to a particular question of interpretation. Where there is no decision directly in the ratio decidendi, indirect judicial interpretation via obiter may provide useful analogies.

But for the losing party or parties in the law suit, there are the 'pieces to pick up'. Facing social disgrace and perhaps hefty economic damages and legal costs, it is suspected that more often than not, there will be resentment about the judgement, the nature of the interpretation of legislation and the role of the judge as its appointed interpreter. Perhaps this is when the smooth interchange of 'justice' and 'motivations'

breaks down here, especially when the majority does not really want what the Courts offer. This resentment can be traced back to the location of the authoritative source of meaning in any dispute about the legislative text, bearing in mind the purposive approach is not adopted by the Courts.

The judicial system regards the judge as being the appropriate interpreter, whose capacity to create meaning is considered to be more or less constrained by a variety of factors, of which the uniquely authoritative terms of the text are but one. But what about the fear that a judge can make it up as s/he goes along? Hence Hoadly's (1924) remark:

"Whoever hath an absolute authority to interpret any written or spoken laws, it is he who is truly the law-giver to all intents and purposes, and not the person who first wrote or spoke them."

(p102)

Also this dislike of 'justice' may be put in other terms. It is a feeling that the Court's conceptions of legitimate expectations are different from one's own. And this is likely to be true, partly because of differences between the reference groups of judges and clients, and partly because of the nature of this one important mechanism (stare decisis) relied upon by the Court to insure conformity to institutionalised expectations. The justification for the doctrine is usually that it provides the best insurance that 'justice' will be served by respecting the expectations that have been built up on the basis of previous decisions.

The 'certainty and predictability' of the law, so important to acceptance of the law as, an integrative mechanism is sought then, by the law's own moral commitment to precedent. This commitment, though interferes with another condition necessary for public acceptance of the legal process: a flexibility sufficient to adapt to changed circumstances, new interests, and different dangers and liabilities attendant upon social change.

So important has this device become indeed, that Courts may be found rendering decisions that are labelled by the Court itself as unjust and inefficient but which the Court insists, it is bound to render nonetheless until the legislature rescues it from the consequence of a prior decision.

The statement remains, however that the Court is for many people something to be avoided if at all possible. There is, it seems, based on the small number of case law on the statutory provisions on the audit, not a very good market for the Court's output of justice; and the other side of the same coin - the Court is not widely regarded as the place to take one's conflicts, except as a last resort.

Furthermore, there are two related characteristics of the law that contribute to making its output of 'justice' unpalatable. One is the fact that the legal system tends to have written into it the assumption that in any dispute one side is right and the other side is wrong. The adversary system is built on this assumption and helps to reinforce it; and the Court is ordinarily empowered only to decide a winner and a loser - not to find a way to help the loser adjust to his or her loss, or to avoid in the future the action that led to the loss, or to alter the conditions that led to the loser's behaving as s/he did.

The second difficulty is related to this. An assumption implicit in the operation of the law is that once rights and obligations have been authoritatively stated, individuals have only one mode of adaptation available to them: acceptance.

The legal system does not include the machinery for insuring the amount of permissiveness, support, denial of reciprocity and conditional reward required to make the Court experience a learning experience. On the contrary, the obscure and complicated legal procedures remain a baffling barrier to the litigant's understanding of what happened to him or her, except to the degree to which counsel informally plays the role of therapist. In consequence, the major impact may be frustration, with little to prevent the frustration from leaving a permanent residue of hostility.

It was noticed that the whole process of judicial interpretation carried out in the Courts remains very much a black box. The Courts themselves have not sought to constrain the interpretive freedom they enjoy by the development of rules dictating what forms of argument are to be used to resolve what questions of interpretation. Any interpretive conventions developed are, as stressed by Lord Reid in *Maunsell v Olins (1975) AC 373 at 382*, 'our servants, not our masters'. In the absence of compelling and comprehensive rules of interpretation, the arguments that the Courts rely upon, therefore, can vary considerably in the degree to which they are determinative of the issue being decided.

As the whole process of how a Court sets about the task of interpreting company legislation is not much known and perhaps a well kept secret or a very subjective one, judicial interpretation can appear to be an activity which is irrational and repressive to a third party. Perhaps there should be attempts to invest further in the literal clarity of the text itself or to make explicit the judicial standards and procedures for statutory interpretation, with any potential for constraints upon the interpreter in terms of the linguistic guidelines that embrace interpretation of statutory texts.

The alternative approaches to textual interpretation (eg literal, contextual) which also draws on theories of language and of hermeneutics, however, regard interpretation as a principled activity in which the interpreter is not free to pick and choose whichever interpretation best serves his or her interests.

Dworkin (1982) has argued that interpreters are constrained by what he identifies as a three-fold obligation to ensure firstly, that many new judicial interpretation fits into the pattern of argument and decision to date, secondly, is reached in good faith in response to present demands on the interpreter and thirdly, maintains the integrity of law. He thus rejects the notion that when interpreting a statute, a judge is free to advance an interpretation which is at odds with received wisdom. Instead he says:

"Each judge must regard himself, in deciding the new case before him, as a partner in a complex chain enterprise of which these innumerable decisions, structures, conventions and practices are the history; it is his job to continue that history through what he does on the day. He must interpret what has gone before because he has a responsibility to advance the enterprise in hand rather than strike out on his own."

(p543)

In view of a judge having still to interpret what has gone before, judges should avoid in interpretation both the kind of dogmatic literalism which cleaves to old values through a blind respect for tradition and precedent, and the opposite danger of a radical approach which destroys all sense of law as a continuing dialogue between past and present (Norris, 1988). Hence, though judicial interpretation will continue to be bound by precedent, it is, one hopes, not a blind procedure.

This section has sought to explore the judicial interpretation of statutes. In doing so five significant characteristics were highlighted, namely that it is authoritative, binding, impartial, non-purposive and is ex-post. All these characteristics then play an important role towards legal effectiveness.

7.7 ENVOI

This chapter has sought to join the pieces (brackets) into a micro view according to each of the four canons of statutory interpretation. Four micro graphs have emerged from the same statutory provision, which resembles the 'four descriptions of the same mango fruit'.

The interpretive researcher in the phase of construction, seeks to gather the micro events in terms of their constituent, analytic mini elements that relate to and define the phenomenon under study which subsequently coalesces into a macro resolution level. This resolution level pursues the interrelation of situated social events or the linkage between events in diverse micro-situations.

Examples of this focus in established social theory include analyses of the economics of exchange between goods and services, or of functional interdependence and role differentiation. Bourdieu's (1975) notion of the 'field' as locus of competition among actors for a monopoly of symbolic capital sees the fields of, for example, scientific disciplines, as the battle ground on which scientists become interrelated by competition. The incorporation of mechanisms for the interrelation of actors and situations in social theory is an obvious requirement of theories which have conventionally worked from empirical (high resolution) data to a more subjective interpretive (low resolution) level of generality.

In the literal stage, it was concluded that the statutory provisions can be reduced to utter nonsense by a strictly literal and wholly unimaginative construction. Whereas in the contextual stage it was noted that a contextual understanding can either modify or reinforce the literal understanding reached. The purposive approach has helped to make the 'indeterminate' statutory provisions more explicit and clearer by tracing it back to the intention of Parliament and the mischief it sought to remedy. And finally, though the judiciary system casts a long shadow over the interpretation of statutes generally, it was noted that the purposive approach was not adopted by the Courts.

Having obtained four graphs from the same statutory provisions, it is now necessary to proceed to merge the different graphs in the next stage of EISI: consolidation so as to obtain further meanings at another resolution level when a 'wholistic' picture is presented. This leads us to the next chapter: The macro stage.

CHAPTER 8

THE MACRO STAGE

8.0 PRELUDE

"For everything there is a season, and a time for every matter under heaven;

*a time to plant, and a time to pluck up what is planted;
a time to love, and a time to hate;
a time to weep, and a time to laugh;
a time of darkness, and a time of light;
a time to cast away stones, and a time to gather stones together;
a time to breakdown, and a time to build up;
a time to 'bracket' and a time to 'consolidate'.*

I have thought about this in connection with all the various kinds of work God has given to mankind. Everything is 'appropriate' in its own time and has a 'purpose'. But though God has planted eternity in the hearts of man, even so, man cannot see the whole scope of God's plan and work from beginning to end."

*Paul Saw (1992)
[adapted from Ecclesiastes 3]*

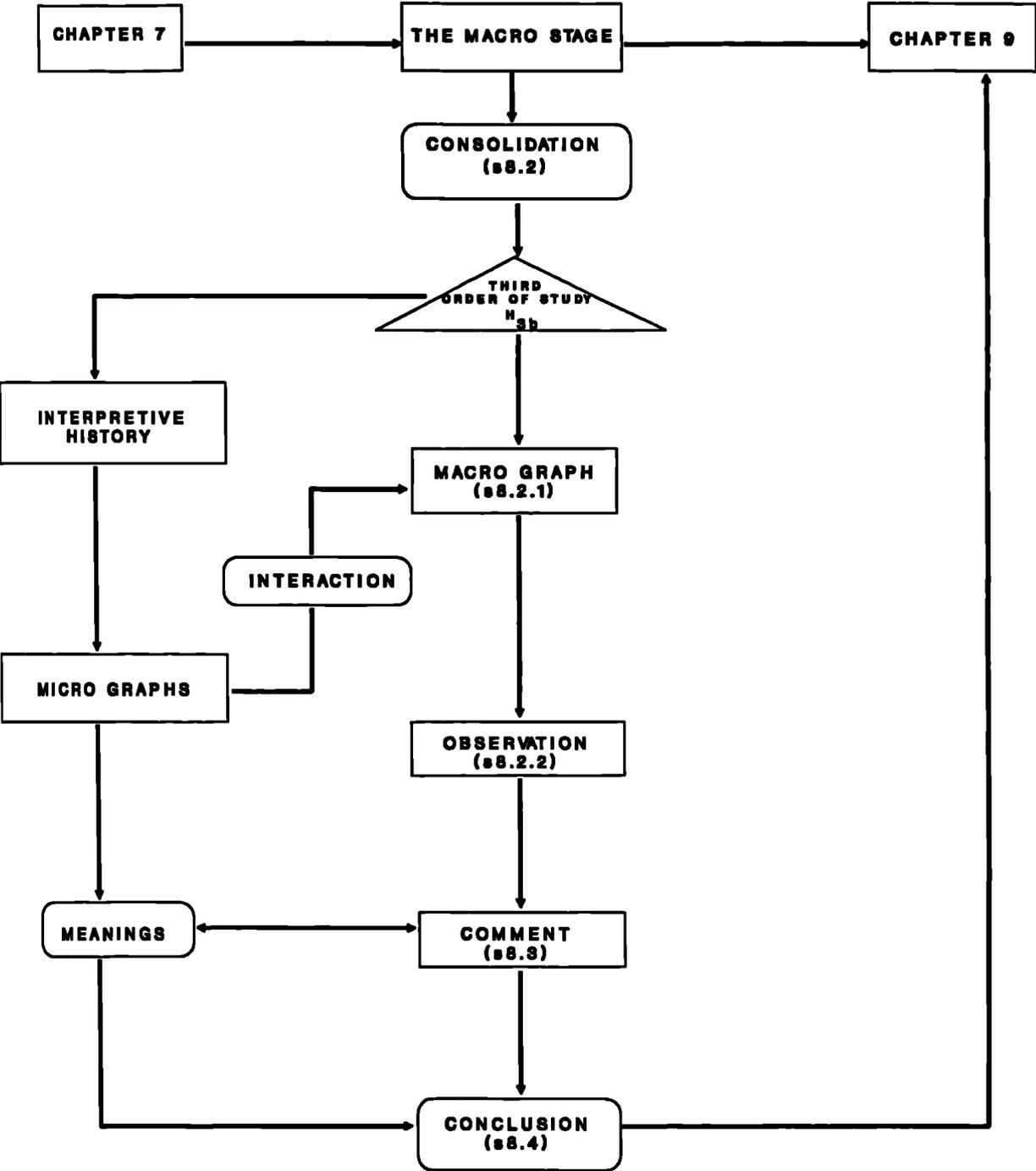
8.1 INTRODUCTION

This chapter completes the EISI stage by consolidating all the constructed graphs. As shown in Figure 8.1, this is the latter half of the third order of study and seeks to provide further understanding and meanings into the similarities and differences on the canons of statutory interpretation.

It starts with a brief recap on consolidation in terms of the micro-macro dialectical perspective towards the utility of knowledge, followed by the macro graph and the observations from it. The bulk of this chapter is devoted to commenting on the observations and interpreting the meanings emerging from it.

Efforts were carried out in the previous chapter to address interrelations at the micro level. Duster's study (1981) of the operationalisation of law draws attention to the transformations which occur when a law emerges from the legal context to its spheres of application. It cannot be restricted to the study of one particular setting: mini, micro or macro. Hence the necessity of this chapter towards the macro setting.

Figure 8.1 : FRAMEWORK OF CHAPTER 8



Here, if one wishes to see macro-level phenomena neither as the source of unintended consequences of micro-episodes, nor as their aggregate, nor their network of interrelations, is to see them as summary 'representations' which are actively constructed and oriented by social actors in micro-episodes. The macro need not appear as a 'layer' of social reality on top of micro-episodes. Rather, it is lodged within micro-episodes and results from the structuring practices which can offer several levels of interpretation for the researcher. Knorr-Cetina (1981) states that:

"The outcome of these practices are representations which thrive upon alleged correspondence to that which they represent, but which at the same time can be seen as highly situated constructions which involve several levels of interpretations and selection."

(p34)

It has been asserted that the micro-macro distinction is dead. It is the force of argument here that even from a divergence of perspectives, that the assertion is misconceived. What is obsolete is the rigid separation, the dualism or opposition, between the micro and the macro. But even as this is recognised, the researcher acknowledges the utility of a language which has these concepts, for teasing out the signs of the visible and the invisible in the interaction and symbolic meaning of action in a statutory environment.

8.2 CONSOLIDATION

Consolidation in EISI is the process where the individual typologies of constructed data are merged to cohere into a 'totality'. It is hoped that by doing so, it will provide an overview, albeit a somewhat loose one of how each typology affects and relates to the others. Here the constructed four micro graphs are merged together into one macro graph to see what further meanings can be generated on this interactionist level.

The concern with subjective interpretations leads to a preoccupation with 'world-view' and a holistic analytic stance, which can never be achieved in a final sense being contingent on re-interpretation (Glassner, 1980). But such a dialectic concern to explore the micro-macro linkage is central to the interactionist philosophy in demonstrating the applicability of data found in the micro stage to a wider context. For the macro-phenomena comprises aggregations and repetitions of numerous micro-episodes (Collins, 1981).

According to Fielding (1989), the conventional distinction between macro and micro has been transacted by the shift away from a concern with functional imperatives to a presumption of the importance of conflict and power in the shaping of macro-level phenomena and of the knowledgeability and autonomy of social actors in the construction of social reality.

Here, in consolidation, one seeks to portray symbolic meanings as an emergent property of the interactional sequences occurring in the diverse micro situations. It is an attempt to describe, reveal and explain that social reality.

8.2.1 MACRO GRAPH

The four micro graphs from the previous chapter are now combined and consolidated into the macro graph as shown in Figure 8.2.

8.2.2 OBSERVATION

Vertically, in terms of the levels, it can be seen that most of the correlations exist in the top half of the graph on level 1. This should be the case since level 1 relates to the statutory level wherein the statutory audit under company law properly resides. What the correlations also tell us is that company law as a statute has not been as 'silent' in establishing a duty on the auditor to detect fraud as generally believed.

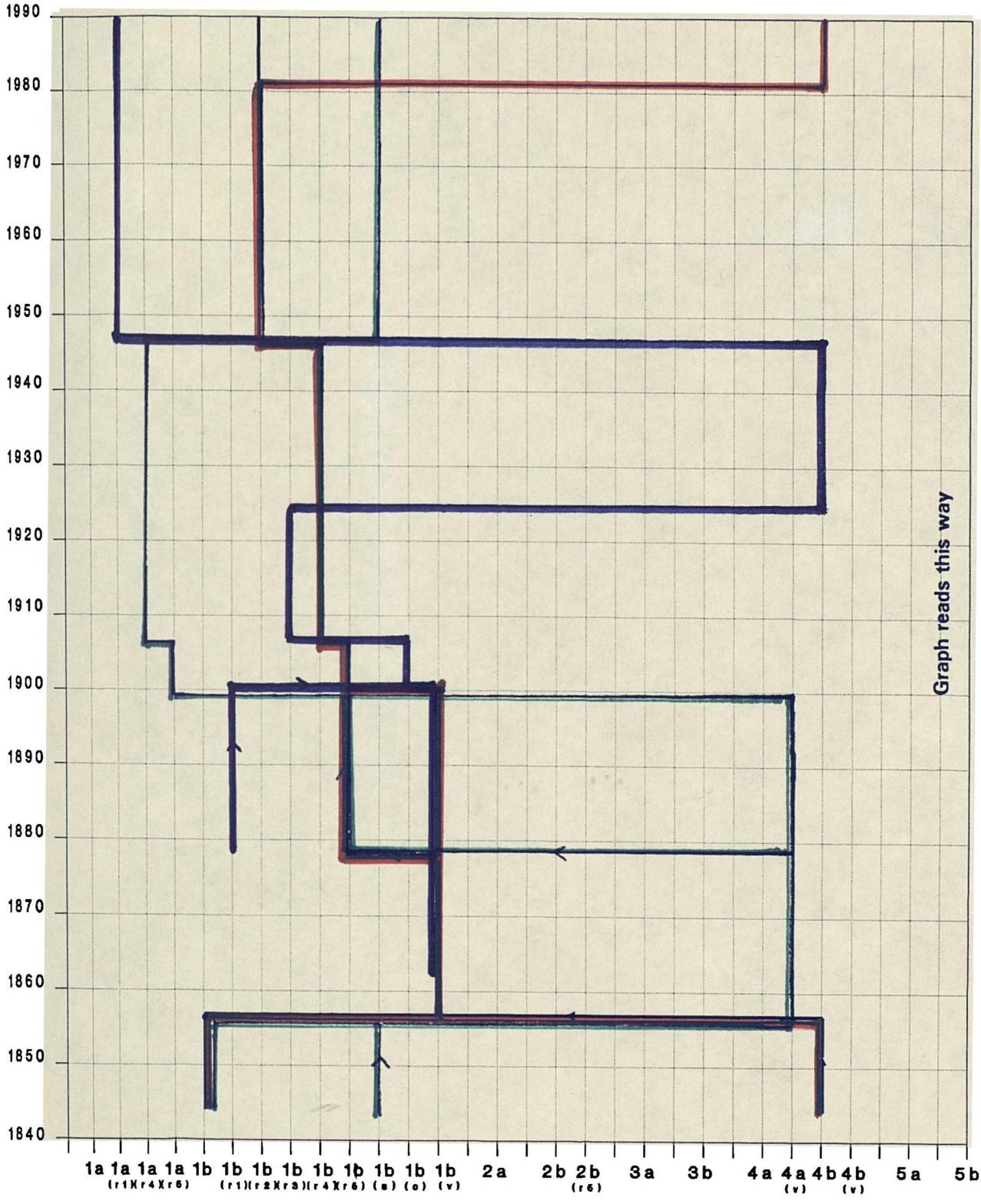
Focussing on level 1, there are very few lines which managed to reach the upper explicit level a. Most of the lines tend to resonate actively on the implicit level b. What can be inferred from this is that company law may not have played an active role in the form of spelling out explicitly the fraud detection duty but has actually played a passive role in implicating for such an implied duty. This may partly explain the pervasive view of statutory 'silence' in fraud detection since the statutory readers may have only associated with such a duty when it is only documented explicitly and expressedly.

Horizontally, the correlations tend to be quite strong pre-1925. After that the interpretations tend to fluctuate and vary a bit more between the levels. This shows clearly that over time, the consensus on the statutory audit to detect fraud, gradually wore thin and began to diverge. This may be partly explained by the law becoming more and more complex in terms of its coverage of breadth and depth in a single Act.

Figure 8.2 :
THE MACRO GRAPH

Key

- / : Literal Graph (Figure 7.3)
- / : Contextual Graph (Figure 7.5)
- / : Purposive Graph (Figure 7.6)
- / : Judicial Graph (Figure 7.7)



Graph reads this way

With the increasing complexity of the law comes the diversity of interpretations when the administrative burden and problem of consistency creeps into statutory formulation between the first and last section of the Act and with the previous and/or other Acts.

English statute law does provide various modes to interpretation or canons of construction. A difficulty arises when the various modes do return conflicting answers, since English law has not yet authoritatively established via statute any complete hierarchy among the modes. This is evidenced by the absence of an isomorphic correlation between the four graphs on the macro graph on a general level or between the 'authoritative' judicial graph and the others.

8.3 COMMENT

8.3.1 JUDICIAL MODE

It was established in the previous chapter, that the interpretation needed by the Courts has by definition, legal authority and priority over all the other literal, contextual and purposive interpretations. This feature of authority and centrality of the judicial mode as a preeminent form of statutory interpretation in the UK should be remembered and contextually appreciated in reading the following sub sections.

8.3.1.1 LITERAL PREFERENCE

But when the judicial graph was interposed with the other graphs, the literal graph had the most mappings and reflected the strongest correlation. Looking at the macro graph for the period 1862 to 1900, the mappings for the judicial and literal graphs were identical for all non-banking companies. Over the same period in comparison, banking companies reflected an upward shift though the judicial graph went up a bit further. It was interesting to note that except for the period 1925 to 1948 where the *City Equitable (1925)* case shifted it down to level 4b, the judicial graph was always either on the literal graph or normally floating slightly close by (normally above) it, implying that the Courts have not only adopted a literal preference but for a slightly higher duty to detect fraud than literally warranted.

Granted that words have a certain elasticity of meaning, the general rule as appears from the macro graph seems to be that judges regard themselves as more bound by the

words of a statute, especially when these words govern the situation before the Court. It would be difficult to overestimate the importance of this literal rule because the vast majority of statutes never come before the Courts for interpretation. If it were not a preference that, in the ordinary case in which the normal user of the English language would have no doubt about the meaning of the statutory words and the Courts will give those words their ordinary literal meaning, it would be difficult for lawyers and other experts to act and advise on the statute in question with confidence. The reference to lawyers and other experts is made advisedly because one would be deceiving oneself if one were to imagine that some form of expertise is not necessary for the comprehension of most statutes. The statutory regulation of most of the affairs with which it deals with is such a complex matter that it is unlikely that it will ever be possible to draft Acts of Parliament in such a way that a significant number of them will be comprehensible to the ordinary layman; but this unfortunate fact should not be allowed to depreciate the importance of the ordinary literal rule.

It is assumed that when judges speak, as they frequently do, about the 'ordinary' or 'literal' meaning of words and phrases, they have in mind the meaning which would be attached to those words and phrases by the normal speaker of English. This is taken to have been the meaning intended by the draftsman or, after due allowance has been made for the metaphor, by Parliament. A judge will probably ask himself the direct question what the ordinary man would understand by the words; but there are limits to the utility of this process in the case of disputed interpretation because everything depends on the context and there is often a choice of ordinary meanings.

8.3.1.2 THE DRAFTSMAN AND THE COURTS

Another point to highlight is that it is important to appreciate the mutual dependence of the draftsman and the Courts when the latter are engaged in statutory interpretation. Drafting is not always as clear as it might be and owing to the lack of human prescience, there will always be cases for which inadequate provision is made by the statute.

It is the Courts' duty to give effect to the intention of Parliament but their main source of information on this matter is based on the wording of the statute. Direct evidence of witnesses (eg MPs) concerning the ordinary meaning of statutory words is not carried

out, probably inadmissible. If the wording is not clear, there is obviously a risk that the Courts will be unable to do their work properly.

On the other hand, the draftsman will find it difficult to convey the Parliamentary intent to the Courts unless s/he knows that they will attach the same meaning to his or her words as that which s/he employs them. Thus there needs to be a commonly used standard of interpretation, and a common feasible standard would be the ordinary or literal meaning of English words. It is for this reason that there is the strongest correlation between the two micro graphs.

8.3.1.2.1 LACK OF DRAFTSMAN'S COOPERATION

At times, however, a lack of cooperation or dependence appears to exist between the Courts and the Parliamentary draftsman. The Courts for example, could lay down a precedent for the CASUS OMISSUS: the inexplicable and probably inadvertent failure of the draftsman to use words entirely apt to cover the instant case. But then the draftsman declines to come to the rescue, by not adding subsequently in an amending Act to the statutory words when a casus omissus is revealed. This means that words appropriate to cover that casus omissus are then contained within the ambit of case law. In the *Leeds Estate (1887)* case, the term 'true and correct' was interpreted by Justice Stirling to mean substantial accuracy, but in the next relevant amending Acts of 1879, 1900, 1907, 1908 and 1929, the same mystic words of 'true and correct' were drafted in repeatedly with no further literal revelation on the casus omissus.

Subsequently, judges have also raised the point that the statutory wording on the auditor's duties (such as true and correct) remains vague. In the *London and General Bank (1895)* case, the judges noted the possible ambiguity of the statutory provisions affecting the auditor's duties, incorporating the phrase 'true and correct'. The Court of Appeal judges again commented in the *City Equitable (1925)* case that s113 of the Companies (Consolidation) Act 1908 does not lay down a clear cut code and that there is abundant scope for discretion on the auditor's duties in the context of 'true and correct'.

Thus the presumption that legislation and the Courts work hand in hand does break down. There is no automatic guarantee that judicial decisions or advice will be acted upon by the legislature and vice-versa as illustrated in the next section.

8.3.1.2.2 DRAFTSMAN'S OVERREACTION

With the progression of time, the draftsman appears to be jumping in first and possibly anticipating a strict construction by the Courts coupled with a total lack of sympathy by the judges (if there should happen to be a *casus omissus*), he produces a statute or provision which is nothing less than horrendous in length. This is evidenced by the progressive lengthy audit report provisions in the Companies Acts of 1948 (~ 400 words); 1967 (~ 440 words), 1985 (~ 460 words); in contrast with the similar but earlier statutory provision in the Joint Stock Companies Act 1844 (~ 60 words) and Joint Stock Companies Act 1856 (~ 110 words). Mitchell (1958) asserted that forms of draftsmanship are often the consequences of the methods and rules of judicial interpretation. In 1969, the Law Commissions (House of Commons) expressed that if defects in drafting complicate the rules of interpretation, it is also true that unsatisfactory rules of interpretation may lead to an over-refinement in drafting at the cost of the general applicability and intelligibility of the law.

The legislative draftsman thus also pose as a target for criticism. Drafting and interpretation are mutually dependent and an excessively literal approach to interpretation can lead to excessively detailed drafting. In his evidence to the Renton Committee, Lord Denning (1975) asserted:

"It is because the judges have not felt it right to fill in the gaps and have been giving a literal interpretation for many years that the draftsman has felt that he has to try and think of every conceivable thing and put it in as far as he can so that even the person unwilling to understand will follow it. I think the rules of interpretation which the judges have applied have been one of the primary causes why draftsmen have felt that they must have a system of over-detail, over-long sentences and obscurity."

(para 19.1)

8.3.1.3 OTHER SUGGESTED APPROACHES

If the prior assertion had been the case, then the more purposive approach to statutory interpretation would have made possible some reduction in statutory detail. Yet, ten years later, Lord Simon of Glaisdale (1985) argued that the recommendations of the Renton Committee have been completely disregarded; and statutes are still drafted in elaborate and incomprehensible detail to deal with every foreseeable combination of circumstances which might arise.

The Renton Committee considered that the adoption of the 'general principle' approach to the drafting of statutes would lead to greater simplicity and clarity. However, this approach to some extent sacrifices immediate certainty and is unlikely to be acceptable at least in certain types of legislation, particularly fiscal and other public law statutes which require an element of certainty in defining the limits, rights and obligations of individuals in relation to the State. There is the danger of drafting in principles so broad that the effect of the statute cannot be assessed without incurring the expense of litigation. As Lord Hailsham (1985) has observed:

"Thou shalt not kill" sounds simple enough. But someone sooner or later, must articulate this into murder, attempted murder, wounding with intent, manslaughter, causing death by reckless driving, professional negligence, the Fatal Accidents Acts, and very many other quite separate provisions. Law must state the legal consequences of states of fact as well as issue simple commands or prohibitions."

(p5)

But Dale (1977) claimed that other European Countries (such as France, West Germany, Sweden) adopt a less detailed and more principled style in their statutes, with less complicated wording and sentence structure. He argues that there should be a change in the current style of legislation to be more general and to reduce the 'verbal impedimenta'.

The view that British statutes should contain less detail has prompted two further suggestions. The first is that the State should engage in less rule-making. As the Renton Committee noted, though this may be approved in theory, modern Governments faced with the complexities of contemporary society rarely consider it appropriate in practice. Samuels (1980) observed that Parliament likes to legislate in very considerable detail, seeking to control and to regulate most aspects of national life, and down to the detail of individual situations. This is supported by the increasing detailed statutory audit provisions.

The second suggestion is that a larger proportion of the State's rule-making should be located elsewhere than in statutes. On this view, it is for Parliament to enact the general principles, and for the Courts to produce the detailed rules necessary for their implementation, as need arises. In practice, this merely has the effect of shifting much of the legislative material from primary legislation into decrees, judicial decisions, codes of practice and ministerial circulars. While the statute becomes easier to read, the

citizen concerned to discover the law is sent on a paper-chase and has to collate the material found in all these different sources. Baldwin and Houghton (1986) noted that this already happens to a significant extent in the British systems of law but to carry the process much further would be without obvious benefit to the citizen and his advisers.

Furthermore, any such shift would have to be assessed in terms of democratic control. At present, statutes are subject to far greater scrutiny in Parliament than the provisions of subordinate legislation, codes of practice and departmental circulars, and unlike them, can in general only be amended by the passing of another Act. What is at issue here is the constitutional function of Parliament, and it is missing the point to suppose that this could be altered by a mere change of drafting practice.

Bell and Engle (1987) argue that the difficulty of many modern statutes results not from the use of obscure terminology but from the complexity of the subject matter coupled with the fact that most changes in the law have to be knitted into the complex fabric of existing statutory provisions. It should also be remembered that most Members of Parliament have a legal background and are thus not always receptive 'to the best popular accounting/auditing language' but sometimes preferring a more legal wording.

In many cases the policy which a statute is designed to implement is far from simple; and the need to achieve a balance between competing interests frequently leads to compromise solutions not capable of expression in terms of principles. Moreover, Parliament appears to be generally reluctant to pass legislation which leaves too much to be decided by the Courts. Advocators of the drafting of legislation in terms of general principles will argue that detailed legislation may fail to fit the circumstances of a particular case, thus leaving the citizen and the Courts in doubt as to what Parliament intended. But it needs to be appreciated that detailed legislation has the enormous advantage of dealing clearly with the great majority of cases likely to arise, unlike general statements of principle whose precise application may be difficult to determine, even in cases where they clearly apply. At the end of the day, the test of good draftsmanship is whether the draftsman successfully conveys the intention of the legislature to the audience to which the statute is primarily directed.

8.3.1.4 NON-PURPOSIVE

But is often said, not without some justification provided by incautious judicial remarks, that the effect of the English rules is that the judge may not 'look at' Parliamentary and pre-Parliamentary materials. Of course, the prohibition is not one against all references to certain materials; it is against the utilisation of such materials as a reason for a decision. This is an important point which needs to be opened up and explored further.

8.3.1.4.1 THE BASIS

The principle underlying the dominant judicial approach to the use (or disuse) of contemporary history as an aid to interpretation was clearly stated by Lord Diplock in *Fothergill v Monarch Airlines Ltd (1981) AC 251 at 279-80*

"The constitutional function performed by Courts of justice as interpreters of the written law laid down in Acts of Parliament is often described as ascertaining 'the intention of Parliament'; but what this metaphor, though convenient, omits to take into account is that the Court, when acting in its interpretive role,...is doing so as mediator between the State in the exercise of its legislative power and the private citizen for whom the law made by Parliament constitutes a rule binding upon him and enforceable by the executive power of the State. Elementary justice or to use the concept often cited by the European Court, the need for legal certainty, demands that the rules by which the citizen is to be bound should be ascertainable by him (or, more realistically, by a competent lawyer advising him) by reference to identifiable sources that are publicly accessible. The source to which Parliament must have intended the citizen to refer is the language of the Act itself. These are the words which Parliament has itself approved as accurately expressing its intentions. If the meaning of those words is clear and unambiguous and does not lead to a result that is manifestly absurd or unreasonable, it would be a confidence trick of Parliament and destructive of all legal certainty if the private citizen could not rely upon that meaning but was required to search through all that had happened before and in the course of the legislative process in order to see whether there was anything to be found from which it would be inferred that Parliament's real intention had not been accurately expressed by the actual words that Parliament had adopted to communicate it to those affected by legislation."

Hence, the dominant judicial approach is non-purposive. But a judge is at liberty to read whatever policy documents he likes in order to arrive at a 'private' understanding of the legal purpose of a statutory provision. The question is whether and in what circumstances it is permissible for him to refer explicitly to such documents when giving judgement. We will start by looking at the Parliamentary materials first, followed by the pre-Parliamentary materials.

8.3.1.4.2 PARLIAMENTARY MATERIALS

Although the justifications offered for the rule are various and have been different at different epochs; it has been generally accepted for well over a century that Parliamentary debates are not admissible as an aid to interpreting a statute. The rule is that expressed by Lord Reid in *Beswick v Beswick (1968) AC 58 at 74*:

"For purely practical reasons we do not permit debates in either House to be cited. It would add greatly to the time and expense involved in preparing cases involving the construction of a statute if counsel were expected to read all the debates in Hansard, and it would often be impracticable for counsel to get access to at least the older reports of debates in Select Committees of the House of Commons; more over in a very large proportion of cases, such a search, even if practicable, would throw no light on the question before the Court."

This statement was approved unanimously in the subsequent cases in the House of Lords such as *Davis v Johnson (1979) AC 264* and in *Hadmor Productions Ltd v Hamilton (1982) 1 ALL ER 1042*. In all three cases Lord Denning M R in the Court of Appeal had referred to extracts from Hansard to justify a particular interpretation of the statutes in question. His approach was declared illegitimate in all three cases. Hansard remains a closed book.

In *Davis v Johnson (1979) AC 264*, Lord Denning went the whole way. In construing s1 of the Domestic Violence and Matrimonial Proceedings Act 1976, he looked at both the 1975 House of Commons Select Committee Report and the reports of Parliamentary debates in Hansard. On the latter, his Lordship said in the *Davis (1979)* case:

"Some may say - and indeed have said - that judges should not pay any attention to what is said in Parliament. They should grope about in the dark for the meaning of an Act without switching on the light. I do not accede to this view...And it is obvious that there is nothing to prevent a judge looking at these debates himself privately and getting some guidance from them. Although it may shock purists, I may as well confess that I have sometimes done it. I have done it in this very case. It has thrown a flood of light on the position."

(pp276-7)

Goff and Cumming-Bruce L J expressly dissociated themselves from Lord Denning's 'heresy'. Cumming-Bruce L J said:

"I am not alarmed by the criticism that I am a purist who prefers to shut his eyes to the guiding light shining in the reports of Parliamentary debates in Hansard."

(p316)

When the *Davis (1979)* case went to the House of Lords, all five Law Lords disagreed with Lord Denning's view. Lord Scarman's opinion is fairly interesting:

"There are two good reasons why the Courts should refuse to have regard to what is said in Parliament or by Ministers as aids to the interpretation of a statute. Firstly such material is an unreliable guide to the meaning of what is enacted. It promotes confusion, not clarity. The cut and thrust of debate and the pressures of executive responsibility...are not always conducive to a clear and unbiased explanation of the meaning of statutory language. And the volume of Parliament and ministerial utterances can confuse by its very size. Secondly, counsel are not permitted to refer to Hansard in argument. So long as this rule is maintained by Parliament (it is not the creation of judges), it must be wrong for the judge to make any judicial use of proceedings in Parliament for the purpose of interpreting statutes."

(pp349-50)

After the decision of the House of Lords in the *Davis (1975)* case, given in March 1978, the matter was thought to be closed; but Lord Denning reopened it. He found a way round the prohibition on the use of Hansard as an aid to construction. Direct reference to Hansard is forbidden but indirect reference is not. Thus if Hansard is quoted in a textbook or published speech, the textbook or speech may, according to Lord Denning, legitimately be looked at by the judge. In *R v Local Commissioner for Administration (ex parte Bradford MCC) (1979) 2 All ER 881* heard in July 1978, Lord Denning consulted a textbook quotation of a public address, which itself contained quotations from Hansard, in order to clarify the meaning of 'maladministration' in the Local Government Act 1974 s 26(1). He justified his action in these words:

"According to the recent pronouncement of the House of Lords in Davis v Johnson, we ought to regard Hansard as a closed book to which we as judges must not refer at all..."

By good fortune, however, we have been given a way of overcoming that obstacle. For the ombudsman himself in a public address to the Society of Public Teachers of Law quoted the relevant passages of Hansard as part of his address and Professor Wade has quoted the very words in his latest book on Administrative Law (4th ed, 1977, p 82). And we have not yet been told that we may not look at the writings of the teachers of law...I hope therefore that our teachers will go on quoting Hansard so that a judge may in this way have the same help as others have in interpreting the statute."

(p 898)

In *Hadmor Productions Ltd v Hamilton (1981) 2 ALL ER 724*, Lord Denning, without any reference to the criticism of the practice made by the House of Lords in the *Davis (1979)* case, proceeded to refer once again to Hansard (at p 731 and 733). He was

criticised for his approach when the *Hadmor (1989)* case subsequently reached the House of Lords. Lord Diplock said:

"There are a series of rulings by this House, unbroken for a hundred years, and most recently affirmed emphatically and unanimously in *Davis v Johnson*, that recourse to reports of proceedings in either House of Parliament during the passage of the Bill that on a signification of the royal assent became the Act of Parliament which falls to be construed is not permissible as an aid to its construction."

[(1982) 1 ALL ER 1042 at 1055]

Miers (1983) noted that the explanatory memoranda and notes of clauses prepared to accompany the Parliamentary stages of a Bill also may not be publicly referred to by a judge for any purpose; and more importantly, the House of Lords has emphatically and unanimously affirmed continuously that recourse to reports of proceedings in either House of Parliament (via Hansard) during the passage of a Bill is not permissible as an aid to the Act's construction.

This position was supported by the Law Commissions (1969), the Renton Committee Report (1975) and was also supported by a large majority of those who spoke in the 1980 and 1981 debates on Lord Scarman's Interpretation of Legislation Bills (House of Lords, Session 13 February 1980 col 276-306; House of Lords, Session 9 March 1981 cols 64-83 and Session 26 March 1981 col 1341-7).

The principal argument used to justify this rule was pointed out by Viscount Dilhorne (1980) that for the vast majority of those who have to apply and interpret the Act, be they solicitors in practice or magistrates, or judges in Crown Courts, Hansard is 'not readily available'. To permit its use would violate Lord Diplock's principle that legal certainty requires that citizens should be able to ascertain what the Act requires by means of accessible information. Equally as Lord Reid stated, the sheer volume of material would excessively increase the work of lawyers and prolong litigation. As Lord Diplock pointed out in *Davis v Johnson (1979) AC 264 at 329*, Parliamentary committees, unlike continental legislatures, do not produce reasoned reports which might explain the adoption or rejection of amendments. But this 'silence' of reason can resurface indirectly through Parliamentary debates.

In addition, there are problems of the reliability and utility of Parliamentary materials. It is by no means clear that a particular statement can be said to represent a general understanding in Parliament of what that Act was intended to do. In many cases,

researches in Hansard may be fruitless because the questions which have arisen in the Courts may have never occurred to the promoters of the Bill or to members of Parliament as raised by Lord Reid in *Black-Clawson (1975) AC 591 at 614-5*.

Most of these practical arguments relate ultimately to the constitutional value of the rule of law. Arguments have been adduced equally from the constitutional value of the separation of powers. The first is that the interpretation of statutes is the constitutional function of the Courts, and that this should not be ceded to another agency (Lord Wilberforce in *Black-Clawson (1975) AC 591 at 629*). The second argument advanced by Lord Hailsham (1983) is less strong. He suggests that comity between the different branches of the state requires that they should not criticise each other and that the Courts would be led inevitably to criticise erroneous interpretations of the Act made in Parliament, if Hansard were to be admissible.

8.3.1.4.3 PRE-PARLIAMENTARY MATERIALS

But what about pre-Parliamentary materials? Lord Diplock in *Davis v Johnson (1979) 264 at 330* stated that reference may only be made to the pre-Parliamentary materials in order to ascertain the mischief which the statute, or the relevant part of it, was designed to remedy as distinct from the meaning of the particular provisions by which it was proposed to remedy that mischief. So for example, in the pre-Parliamentary Davey Committee Report (1895) leading to the Companies Act 1900, the Courts could refer to the mischief to be remedied (ie fraud in relation to the formation and management of companies) but not the meaning of the audit provisions designed to remedy the prevalence of fraud. One is left with a nagging question concerning the extent to which it is possible to consider the Davey Committee Report for the purpose of ascertaining the mischief to be remedied without being influenced by its recommendations concerning the remedy.

Can this distinction be justified? Lord Reid justified it on the ground that, if pre-Parliamentary materials were accepted as evidence of what Parliament intended in relation to the case before the Court, it would be necessary to abandon the prohibition of the citation of Hansard. He said in *Black-Clawson (1975) AC 591 at 614*:

If we are to refrain from considering expressions of intention in Parliament, it appears to me that a fortiori, we should disregard expressions of intention by committees or royal commissions which reported before the Bill was introduced."

This is similar to the earlier reasoning of Lord Wright in *Assam Railways and Trading Co Ltd v IRC (1935) AC 445 at 458*, according to which pre-Parliamentary reports are 'even more removed from value as evidence of intention' than the language of a Minister of the Crown. There is of course much force in this reasoning, but it loses some of its strength when it is remembered that one of the grounds for rejecting Parliamentary debates is their inaccessibility. This does not apply to pre-Parliamentary materials.

After making the point that, if a clause-by-clause commentary on a draft Bill subsequently enacted by Parliament were admitted as evidence on the meaning of a particular provision, there would be two documents to construe instead of one. Lord Wilberforce said in *Black-Clawson (1975) AC 591 at 629-30*:

"Legislation in England is passed by Parliament and put in the form of written words. This legislation is given legal effect upon subjects by virtue of judicial decisions, and it is the function of the Courts to say what the application of the words used to particular cases or individuals is to be. This power which has been devolved on the judges from the earliest times is an essential part of the constitutional process by which subjects are brought under the rule of law - as distinct from the rule of the King or the rule of Parliament; and it would be a degradation of that process if the Courts were to be merely a reflecting mirror of what some other interpretation agency might say."

It would be a degradation if that was so. But, if a judge who is in doubt about the meaning of a statutory provision takes note of what its author thought it meant, it is a little tendentious to describe him as a 'reflecting mirror'. It is difficult not to have some sympathy with the point made by Lord Simon of Glaisdale in *Black-Clawson (1975) AC 591 at 652* that rejecting the commentary as evidence of intended meaning of a particular clause was like gazing in the crystal ball when you can read the book. He added that it is perversely neglecting the reality, while chasing shadows.

The admissibility of pre-Parliamentary reports was again strongly opposed by representatives of the legal profession during the debates on Lord Scarman's Interpretation of Legislation Bill in 1981. The principle argument was the inaccessibility of these documents to the ordinary practitioner and the increased cost of litigation which admissibility would cause.

Viscount Bledisloe commented that:

"If one has to look at reports, one must...charge for it. The material referred to in the Bill is not available even in the best organised of barristers' chambers, let alone in solicitors' offices or perhaps in the libraries of the lower tribunals in the land, which presumably, have to give effect to this Bill as much as your Lordship's House and places where the noble and learned Lord, Lord Scarman sits.

I think the expensiveness was recognised. It may be said that that is a mere matter of cost which should not be set against procuring justice; but I venture to suggest that cost itself can be very productive of injustice. One sees frequently many litigants - people with legal problems, people who do not qualify for legal aid but who none the less are not of unlimited means - who are daunted from receiving their true legal rights because of the cost of litigation and the cost of seeking advice. They may not enforce those rights at all or they may settle for too little. Anything which adds to the cost of litigation or the cost of obtaining legal advice is, of itself, productive of a real and frequent injustice.

The loser may go away feeling that he has had a good run for his money, but the winner - who may in fact, in the end by paying the bill - will go away knowing that it has cost him far too much to enforce his rights because far too much material was before the Court."

(House of Lords, Session 9 March 1981 col 69-70)

8.3.1.4.4 THE ARGUMENTS

Upon further reflection on the above arguments there appears to be four common threads of objections to the purposive approach towards reference to Parliamentary and pre-Parliamentary materials.

- a) The first was essentially pragmatic. As the interpretation was not confined to the judges only, it was argued that legal counsel would feel obliged to obtain access to such documents in case they offered support for alternative interpretations. This in turn would increase their workload, which would ultimately be translated into lengthier proceedings and higher costs [Viscount Bledisloe (1981)].

Moreover, what about the 'interpretations' carried out by either parties in out of Court settlements, which one suspects are fairly pervasive. Whether it would be right or wrong to call this process 'interpretation', it is the process to which statutes are most commonly subjected and one which renders it essential that the first rule of statutory interpretation should be to give effect to the literal or where appropriate, the technical meaning of statutory words. The fact that

most statutes are probably 'interpreted' in this sense out of Court is one of the justifications of the restrictions on admissible evidence on the purpose of a statute.

- b) The second objection concerned the value to be obtained from such documents. Although reading a committee report may encourage an informed understanding of the statutory scheme, there will be many occasions on which such a report will not highlight for the reader the specific problems of interpretation. This lack of direct reference has traditionally been a factor relied upon to justify the limited formal consultation which the judiciary allow themselves, and is seen most forcefully in the reaffirmation of the formal exclusion of Parliamentary debates as an aid to interpretation. Parliamentary debate is seldom concerned, even at the Committee stage, with precise problems of interpretation and was seen by Gibb (1984) as an unreliable indicator of Parliament's intentions. These conditions apply, though with less force, to pre-legislative policy documents. However, the limited reliance which may, under current practice, be placed upon such documents, raises the question, more starkly posed by the 1981 Interpretation Bill of what weight is to be attached to them. The Bill's answer in clause 1(2) was that this should be *"no more than is appropriate in the circumstances"* was thought to introduce too great a degree of indeterminacy into an already uncertain exercise. Lord Elwyn-Jones said:

"The task is to strike a balance between the advantages for a limited number of cases from enabling the Courts to refer to material which might be relevant in a question of interpretation and the price to be paid for a change which might impose additional uncertainties on those who are concerned with the effect of legislation and with litigation and which would lead to extra work in the machinery of government."

(House of Lords, Session 13 February 1980, col 284-5)

A further consideration is that, even assuming its accessibility, relevance and reliability, this second purposive text will also require interpretation and there is obviously no guarantee that this will be any the easier or more explicit than for the statutory text it is thought to illuminate. For example, at the mini purposive stage for the Joint Stock Banks Act 1844, away from the statutory text of s4, the Parliamentary materials used words such as 'improper and improvident acts' rather than explicitly 'fraud'. But when it was seen in the context of the other terms like the audit 'offering protection' and 'corrective', interpretation was

necessary on this secondary purposive text to relate it fraud, at least by implication. It was found in all the three modes of interpretation so far, that language is still a rather clumsy tool. It is rarely sufficiently precise to eliminate the need for interpretation. In the words of Justice Holmes:

"A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in colour and context according to the circumstances and the time it is used."

(Towne v Eisner (1981) 245 US 418 at 425)

- c) The third objection was that the possibility of recourse to a variety of texts offended against the primary constitutional consideration, which is that it is the Act, and the Act alone, that expresses Parliament's intentions. The traditional understanding of a judge's duty is that it is to give effect to the intentions of Parliament only as they are expressed in the words of the statute. Moreover, the rule of law as a constitutional principle requires that a citizen, before committing himself to any course of action, should be able to know in advance what are the legal consequences that will flow from it. Where those consequences are regulated by a statute, the source of that knowledge is in what the statute says. Accordingly the citizen is entitled to rely on the words of the statute alone, or where it is judicially interpreted, on an interpretation based upon what he might reasonably understand by those words. Finally as Lord Reid puts it in *Black-Clawson (1975) AC 591 at 614*, '*construction of the provisions of an Act is for the Court and no-one else*'.
- d) These three objections were mainly voiced by representatives of the professional users' groups and by the judiciary; the final objection was more concerned with the implications for the Government. These were that the drafting process would be made very much more difficult as the draftsman would have to prepare legislation knowing that those interpreting it would also be construing other documents with the statutory text to arrive at an understanding of it. In consequence of this difficulty, the completion of the legislative programme would be under constant threat of delay in that difficulties would be created during the Parliamentary stages, as reference would have to be made to those documents which could be used as aids to interpretation, but with whose conclusions neither the Government nor

Parliament might wholly agree. All these might frustrate the Government's objective of attaining legal effectiveness.

8.3.1.4.5 THE COUNTER-ARGUMENTS

On the other hand, there are counter-arguments.

a) Sacks (1982) said:

"If the judicial role is to apply the intention of Parliament, it appears perverse that the judges refuse to seek the legislative intent in the very place where it might be found - that is, the background materials to the statute."

(p143)

Lord Simon of Glaisdale has also argued that it is wrong to ignore them when they do provide clear answers to the questions before the Court. In *Black-Clawson (1975) AC 591 at 646*, he said:

"Where Parliament is legislating in the light of a public report, I can see no reason why a Court of construction should deny itself any part of that light and insist on groping for a meaning in darkness or half-light."

It seems that the Courts are interpreting the statutes too narrowly without adequate regard to the social purpose of legislation. There seems to be a rather conservative approach to the interpretation of statutes designed to effect social change.

b) Since legal practitioners are likely to have access to textbooks and commentaries on a statute, which may well digest the relevant elements of the Parliamentary and other materials on difficult points, the problem of accessibility need not be overwhelming. But this remains a minority opinion. These restrictions, coupled with the almost total absence of preambles in modern statutes, mean that the Courts' opportunities of appreciating the full purpose of complicated legislations are limited too.

c) Bennion (1984) noted that there were some cases in which judges have expressly referred to Hansard in their opinions as supporting justifications for the conclusions that they have reached. Even those who, like Lord Hailsham

(1981) 'would forbid the use of Hansard almost over my dead body', admitted in 1983 to a private reading of such material. But of course, it does not constitute an admissible legal justification for a decision. As he puts it:

"A judge who is impressed by a point picked up in private reading should of course put it before counsel to enable them to deal with it, and counsel must argue any such point of which he desires to make use without referring to the source."

(p69)

There is force in the argument that the issue might be better resolved by giving due weight to Parliamentary debates as guides to interpretation coupled with the sanction of costs for unnecessary citation, rather than by a blanket prohibition.

8.3.1.4.6 SUB CONCLUSION

The British Court's doctrine of 'purposive' construction is more literalist than the European variety and permits a strained construction only in comparatively rare cases. Lord Denning said:

"(European judges) do not go by the literal meaning of the words or by the grammatical structure of the sentence. They go by the design or purpose behind it. When they come upon a situation which is to their minds within the spirit - but not the letter - of the legislation, they solve the problem by looking at the design and purpose of the legislature - at the effect it was sought to achieve. They then interpret the legislation so as to produce the desired effect. This means they fill in gaps, quite ashamedly, without hesitation. They ask simply what is the sensible way of dealing with the situation so as to give effect to the presumed purpose of the legislation.

(James Buchanan and Co Ltd v Babco Forwarding & Shipping (UK) Ltd (1977) 2 WLR 107 at 112)

In the exercise of holding that the language of a statutory provision does sustain the interpretation which a purposive argument requires, the Courts may be open to the criticism that they have placed too great an emphasis on the express words in the Act at the expense of the statutory purpose obtained from Parliamentary materials. This is one of the criticisms that is particularly associated with the suggestion that Courts should place greater reliance on policy documents when interpreting statutes.

Despite the difficulties, there appear to be three constitutional reasons for retaining the notion of 'the purpose or intention of Parliament'.

- a) The first is that it expresses the subordination of the judiciary to Parliament. As Hurst (1981) puts it:

"Of course we use a fiction if we speak of the legislature as if it were a being of one mind. But so durable a fiction endures because it has a use validated by experience. This formula reminds all who deal with a statute (eg judges) that they are operating in a field of law in which they are not free to define public policy simply according to their own judgement."

(p33)

The Courts have to give effect to the instructions they have received from the Parliament through the enactments and do not simply decide as they think best. But this dichotomy can be overstated. Even though Courts do receive the enactments, they are usually left with a degree of latitude about how to execute them when the statutory words are indeterminate. Perhaps, the notion of 'the intention of Parliament' identifies a perspective or orientation within which judicial decision-making takes place, rather than a rigid set of enactments whose execution requires little originality or discretion.

- b) The second reason for appealing to 'the intention of Parliament' seems to be the desire of judiciary to disavow a large creative role in the interpretation of statutes. Lord Denning may have said in *Magor and St Mellons RDC v Newport Corporation (1950) 2 ALL ER 1226 at 1236*:

"We sit here to find out the intention of Parliament and of Ministers and carry it out, and we do this better by filling in the gaps and making sense of the enactment."

But this approach was rejected by the higher House of Lords when the case was appealed there. Lord Simonds in *Magor and St Mellons RDC v Newport Corporation (1952) AC 189 at 191* said:

"My lords, at a time when more and more cases involve the application of legislation which gives effect to policies that are the subject of bitter public and Parliamentary controversy, it cannot be too strongly emphasised that the British Constitution, though largely unwritten, is firmly based upon the separation of powers. Parliament makes the laws, the judiciary interprets them. When Parliament legislates to remedy what the majority of its members at the time perceive to be a defect or lacuna in the existing law..., the role of the judiciary is confined to ascertaining from the words that Parliament has approved as expressing its intention what that intention was, and giving effect to it. Where the meaning of the statutory words is plain and unambiguous, it is not for the judges to invent fancied ambiguities as an excuse for failing to give effect to its

plain meaning because they themselves consider that the consequences of doing so would be inexpedient or even unjust or immoral. Under our Constitution, it is Parliament's opinion on these matters that is paramount."

- c) The last reason appears to be that of legal certainty, which was invoked by Lord Diplock and other members of the House of Lords (esp Lord Scarman at p551) in the *Duport Steels (1980)* case. This view was also supported by Lord Simon of Glaisdale in *Stock v Frank Jones (Tipton) Ltd (1978) 1 ALL ER 948*. The view was that the certain injustice of legislative text may be preferable in the context of legal certainty for the citizen in the long run than the uncertainty caused by judicial interventions to correct perceived 'injustices'.

Even if an appeal to 'the intention of Parliament' is justified, the use of it can differ from judge to judge. Such a statement of attitude or approach is an expression of a constitutional role adopted by judges, and the quotations given above illustrate that judges are not unanimous in their perception of what is the constitutional role for them to adopt.

For really, the continuing problem is how to convey messages to judges otherwise than by statute. Lord Wilberforce (1981) may well have been right when he doubted whether law reform can really grapple with the complexities, dynamics and problems of statutory definition. He said it is a matter of educating the judges and practitioners and hoping that the work is better done.

8.3.2 LEGAL EFFECTIVENESS

The preceding points seek to highlight the respective competences of the Courts and the draftsman, including the Government in the overall context of developing and changing the law. Nevertheless, most legislation is never subject to judicial interpretation. Therefore saying as exactly as the Government intends, where these boundaries lie, has the considerable advantage of determining the great majority of questions as to the applicable law. Neither is an increased delegation of discretion to the judiciary an uncontroversial matter. For in areas of political, social or economic sensitivity, the Government may well prefer to give the Courts detailed guidance on how the legislation giving effect to its policies is to be interpreted. A statute is above all, part of the political process. Most of Government policy is established and implemented by means of ministerial decisions or directions, or by delegated legislation.

Engle (1983) calculated that in a typical session, an average of only 42 programme Bills are presented to Parliament by the Government. Most of them, however, are likely to be of considerable importance, both because of their political content and because of the authority they provide for subsequent ministerial actions or for delegated legislation. Judicial interpretations can affect the success of such political programmes.

Perhaps a more realistic approach argues that within the constraints of the draftsman's primary concern to obtain precise legal effect, intelligibility is probably better secured by close attention to the design of the legislation, including its sentence structure, choice of language and internal coherence, than by any attempt to supplant existing practices wholesale. Nevertheless, as between legal effectiveness and intelligibility,

"the test is that when it is passed, and a trained lawyer or judge has mastered its intricacies, the meaning is clear (in the sense of being unambiguous) and the intention carried out. Subject to this, the second object is to make the Bill as intelligible as possible to Parliament and the general public."

Kent (1979) p97

8.3.2.1 INTELLIGIBILITY

On the second object mentioned above coupled with insights from the micro stage, it was evidenced that there has been repeated difficulties and criticisms in the intelligibility of company statute law in the context of audit legislation.

8.3.2.1.1 JUDICIAL EXASPERATION

Legal language is used because the English practice aims to legislate by using precise words seeking to cover any conceivable situation and allowing of no loopholes. Complaint is frequently made that the use of legal language (eg true and fair) makes the legislation unintelligible to the layman. And there is sufficient evidence of this in the mini and micro stages. Indeed as seen in the micro judicial stage, there were cases where the statutory provisions were seemingly unintelligible to lawyers, where both counsel and judges arrived at three different levels of duties for the auditor. In appeal cases, it was observed as in the *Caparo Industries (1990)* case that different judges expressed diametrically opposite views with regard to the ordinary meanings of the statutory provisions.

Displays of judicial exasperation with legislative drafting are also not uncommon elsewhere. In *Davis v Johnson (1979) AC 264 at 333*, Viscount Dilhorne said of s1 of the Domestic Violence and Matrimonial Proceedings Act 1976 that:

"Few, if any sections of a modern Act can have given rise to so much litigation in so short a time and to such a difference of opinion."

It has also been said that the Housing (Homeless Persons) Act 1977 (now part III of the Housing Act 1985) is not an easy statute to interpret and Justice Comyn expressed a fervent hope that it will not be allowed to give rise to running battles [*R v Slough Borough Council (1981) 2 ALL ER 601 at 610*]. In *Thanet District Council (1982) 3 ALL ER 1135 at 1136*, Lord Bridge described the 1977 Act as a 'fruitful' source of litigation.

8.3.2.1.2 USER EXASPERATION

Criticisms have also come from the 'ultimate users', an expression used by the Renton Committee (1975) to refer to the many groups and individuals, official and otherwise, who routinely interpret and apply statutory provisions. Their argument is that there is too much detail in legislation, and that is written in an over-elaborate style compromising clarity and simplicity of expression. Lord Donaldson M R in *Merkur Island Shipping Corporation v Laughton (1983) 2 WLR 45 at 66-67* commented:

"But I do not criticise the draftsman. His instructions may well have left him no option. My plea is that Parliament, when legislating in respect of circumstances which directly affect the 'man or woman in the street' or the 'man or woman on the shop floor', should give as high a priority to clarity and simplicity of expression as to refinements of policy. Where possible statutes or complete parts of statutes, should not be amended but re-enacted in an amended form so that those concerned can read the rules in a single document when formulating policy, ministers, of whatever political persuasion, should at all times be asking themselves and asking Parliamentary counsel: Is this concept too refined to be capable of expression in basic English? If so, is there some way in which we can modify the policy so that it can be so expressed? Having to ask such questions would no doubt be frustrating for ministers and the legislature generally, but in my judgement this is part of the price which has to be paid if the rule of law is to be maintained."

Lord Donaldson's remark has its roots way back in 1975. The Renton Committee Report on the Preparation of Legislation (Cmd 6053) recommended that legislation should be arranged to suit the convenience of users, not legislators. It was said that the modest system of using explanatory notes with new Bills should be extended and

that statements of purpose and principle should be encouraged. It was recommended that there should be more Parliamentary draftsmen, and more and quicker consolidation of statutory provisions.

It is important for democracy that the law should command the respect of the people who are expected to abide by the 'rules'. It is equally important that they should know what 'the rules' are. But as seen in the mini stage, it appears to be indeterminate and at the micro stage, differing meanings according to the canons adopted.

8.3.2.1.3 CLARITY AND SIMPLICITY

Legislation expressed in vague and cumbersome language is likely to bring the law into disrepute because it cannot be understood by those whose duty it is to observe. Clarity and simplicity of expression should be the objectives of the draftsman.

In *Merkur Island Shipping Corporation v Laughton (1983) 2 ALL ER 189*, Lord Diplock also made a plea for greater clarity and simplicity in legislative drafting. This was in a case where the House of Lords had to consult three Acts of Parliament, none of them intelligible by itself, in order to decide whether some secondary industrial action by employees was actionable in tort. His Lordship said:

"But what the law is...ought to be plain. It should be expressed in terms that can be easily understood by those who have to apply it even at shop floor level. Absence of clarity is destructive of the rule of law; it is unfair to those who wish to preserve the rule of law; it encourages those who wish to undermine it. The statutory provisions which it became necessary to piece together into a coherent whole...are drafted in a manner which, having regard to their subject matter and the persons who will be called on to apply them, can in my view, only be characterised as most regrettably lacking in the requisite degree of clarity."

(at 198-199)

8.3.2.1.4 THE LAYMAN vs EXPERT DILEMMA

The lack of intelligibility in legislation is not a matter of concern only to its users, including the judiciary. If the Government wishes its policies to have legal effect, then it will be concerned in ensuring that its legislation is intelligible to those upon whom it relies to interpret and apply it.

But intelligibility in legislation is not a simple issue. As there are different audiences, so there are different levels of intelligibility to consider for the same statutory provision. Hutton (1961) expressed thus:

"The same document has to be designed to satisfy two distinct 'legislative audiences'; first (in point of time) the Parliamentary audience, mainly composed of laymen, whose primary need is to ascertain, with the minimum of labour and preferably no reference to any document other than the Bill itself, what is the general purpose and effect of each clause or section which they are asked to pass; and secondly, the expert lawyers and other professionals who will seek to find in the Act a specific answer to each specific question upon which they have to advise or decide. One customer wants a picture and the other wants a Bradshaw."

(p21)

Thus a major audience is the ordinary 'man or woman in the street' whose rights and duties are affected by the legislation. For them a provision is intelligible when it makes clear what actions are required by whom, in what order, and subject to what formalities. However, while Andrew (1989) noted that in *The Review of Government Legal Services* it was acknowledged that it is important that legislation should be intelligible to those who may be affected by it, demands for simplicity of expression can be unrealistic as highlighted by Driedger (1971):

"There is always the complaint that legislation is complicated. Of course it is, because life is complicated. The bulk of the legislation enacted nowadays is social, economic or financial, the laws they must express and the life situations they must regulate are in themselves complicated, and these laws cannot in any language or in any style be reduced to kindergarten level, any more than can the theory of relativity. One might as well ask why television sets are so complicated. Why do they not make television sets so everyone can understand them? Well, you can't expect to put a colour image on a screen in your living-room with a crystal set. And you can't have crystal set legislation in a television age."

(p78)

Many people have thought (and many still think) that in a democracy, the laws should be such as can be understood directly by the citizen. He cannot plead ignorance of law as an excuse of his transgression. Common fairness requires that knowledge of law should therefore be accessible. Here, as elsewhere, life defeats fairness.

A further difficulty is that the search for intelligibility may lead to imprecision, making the legislation vulnerable to challenge in the Courts.

Intelligibility means different things to different people, and is not the only concern that they may have. For example, as highlighted by Miers and Page (1990), the professional interpreter generally desires a statutory provision to be legally certain. That is, to be unambiguous and to leave as little room as possible for competing interpretations in its application to particular circumstances, but to draft such a text often means that intelligibility - ease of understanding - is sacrificed. Similarly, ministers prefer brevity, but the pressure to introduce greater detail, for example to allay Parliamentary opposition to a controversial measure, may prove difficult to resist. Intelligibility may be further reduced by the inclusion of clauses for which the department has been seeking a suitable vehicle, or because it has changed, or was initially unclear about its policy.

Nevertheless, it is an obvious indictment of the drafting process if a user such as the auditor who is familiar with the subject-matter cannot after a reasonable expenditure of intellectual effort and within a reasonable time, understand a provision. However, while there has been extensive debate and numerous examples cited of apparently unintelligible audit legislation, it is noted that there has been little systematic analysis of what intelligibility means to the various groups who constitute the legislation's audience.

8.3.2.1.5 INERTIA

The key factors affecting the implementation of proposals to improve the intelligibility of legislation are therefore, as Cross (1981) observed, the pragmatism of Parliamentary Counsel Office and the inertia of Government.

"In truth the debate (about drafting style) is somewhat academic because there is not the slightest likelihood of Parliamentary Counsel voluntarily abandoning their system of drafting or of the Government compelling them to do so."

(p123)

But it is not only the Government which displays little enthusiasm for reform of the drafting process. The Commons' Debate on the Renton Report, which was the first investigation of the subject for nearly a century was attended by only a handful of members as noted by Peyton (1975). In part, this may be attributable to the perception that the subject is a matter of legal expertise only, but this is a short-sighted view since

the success with which the Government's policies are carried out necessarily depends on their legal intelligibility. Hence, the inertia.

8.3.3 LITERALISM REVISITED

Coming back to the literal issue at the macro stage, the entrenchment of the literal interpretation reflected the judiciary's conception of their role as interpreters. Chief Justice Tindal in *Sussex Peerage Claim (1844)* 11 CL & FIN 85 at 143 said:

"The only rule for the construction of Acts of Parliament is that they should be construed according to the intent of the Parliament which passed the Act. If the words of the statute are in themselves precise and unambiguous, then no more can be necessary than to expound those words in that natural and ordinary sense. The words themselves alone do, in such a case, best declare the intention of the lawyer."

8.3.3.1 THE INTENTION OF PARLIAMENT

The major judicial statements with regard to the intention of Parliament have been made in cases in which the issue has been whether statutory wording could be ignored or the meaning of statutory language strained in order to prevent an injustice, or suppose injustice which, it was thought could not have been contemplated by Parliament. The answer, as evidenced in the micro purposive stage has almost always been in the negative, and the preponderant view seems to be that, when the question is whether Parliament did or did not intend a particular result, the 'intention of Parliament' is what the statutory words mean to the normal speaker of English. The fact that a judge feels confident that, had the situation before him been put to them, the Members of the Parliament in which the statute was passed would have voted for a different meaning or for additional words, is immaterial.

Such an approach reflects a conception of the judicial role which is fundamentally linked to the constitutional principle of the rule of law. As Lord Simon of Glaisdale expressed the connection in *Stock v Frank Jones (Tipton) (1978)* 1 ALL ER 948 at 953:

"in a society living under the rule of law, citizens are entitled to regulate their conduct according to what a statute has said, rather than by what it was meant to say or by what it would otherwise have said if a newly considered situation had been envisaged."

8.3.3.2 LITERAL vs JUDICIAL

Although this rule was subject to the qualification that the ordinary meaning of the words could be modified where a literal interpretation led to a result that was absurd or inconsistent with the rest of the statute, the primary obligation on a Court was to give effect to their plain literal meaning. Arguments based on the purpose of the Act as shown earlier were subordinated to a literal interpretation, and indeed until recently, such arguments have typically been presented as being appropriate only where the words do not apply to the facts of the case at hand.

8.3.3.3 LITERAL vs PURPOSIVE

While there is obvious value in interpreting words in their ordinary sense in context, it is evident from the macro graph that the judiciary did place too great an emphasis upon literal interpretation at the expense of purposive interpretation. As was also supported by Bell and Engle (1987), the most frequent complaint concerning the contemporary approach of the Courts to statutory interpretation is that it is excessively literal. All too frequently, when the judicial graph is compared with the mismatch on the purposive graph, the purpose of legislature is frustrated by an undue insistence on the part of the Court in applying the statutory words to the particular case in a strictly literal sense.

In their review of statutory interpretation in 1969, the Law Commissions of the House of Commons (1969) concluded in paragraph 80(c) that there was a tendency among some judges to over-emphasise a narrow version of the literal rule and to refuse to go beyond the meaning of a statutory provision in the light of its immediate and obvious context. Can it be that the Courts being too timorous to step out when confronted with an obvious mistake or omission in a statute?

8.3.3.4 LITERAL v CONTEXTUAL

As seen from the macro graph, when the literal graph is compared with the contextual graph, there can be more than one ordinary meaning when the context is brought in. In the event, the judge or a user may consider that there is sufficient doubt on a literal meaning. But in other events, he may also conclude that there is no doubt that one of the meanings is the ordinary or literal one. This was very much evident in the post-1981 period where even though the contextual graph dipped substantially to level 4(b),

the literal graph maintained its level at 1b(r₂), just as the judicial graph was sustained at level 1a(r₁)(o).

From the macro graph, in the context of audit legislation, the literal and contextual graphs were in harmony except for the period post-1981. It is nevertheless difficult to reconcile always the literal meaning with the contextual one. One understands the meaning of words from their context, and in the ordinary life, the context includes not only other words used at the same time but the whole human or social situation in which the words are used.

For example, the literal rule stipulates that working hours are from 9 am to 5 pm. Suppose it snows on one Friday so badly that it is foreseeable that by noon, all forms of transport will be stranded. The literal meaning lays down the rule that staff has to carry on work until 5 pm, of which there is no doubt to it. But the contextual meaning to that rule requires one to bring in the adverse social climatic conditions; which common sense dictates that the literal rule be abandoned and that the working hours should be curtailed for that day. On its face, the literal rule seems to forbid this common sense approach to statutory interpretation. A consistent rigid adherence to the literal rule leads to legalism as opposed to situationism, as coined by Fletcher (1978).

8.3.3.5 A CRITIQUE

The literal rule has often been criticised. Lord Diplock stated thus:

"Where the meaning of the statutory words is plain and unambiguous, it is not for the judges to invent fancied ambiguities as an excuse for failing to give effect to its plain meaning because they themselves consider that the consequences of doing so would be inexpedient, or even unjust or immoral. In controversial matters, there is room for differences of opinion as to what is expedient, what is just and what is morally justifiable. Under our constitution, it is Parliament's opinion on these matters that is paramount."

[Duport Steels Ltd v Sirs (1980) 1 All ER 529 at 541]

As stated by Williams (1982):

"But what is a 'real' ambiguity and what is a 'fancied' ambiguity? Consider the following case [of *Richard Thomas & Baldwins Ltd v Cummings (1955) AC 321*] decided by the House of Lords on the construction of the Factories Act. This Act requires dangerous parts of machines to be constantly fenced while they are 'in

motion'. A workman adjusting a machine removed the fence and turned the machine by hand in order to do the job. Unfortunately he crushed his finger. Whether the employers were in breach of the statute depended on whether the machine was 'in motion'. In the primary or literal sense of the words it was, but since the machine was not working under power and was only in temporary motion for necessary adjustment, the House of Lords chose to give the words the secondary meaning of 'mechanical propulsion'. Since the machine was not being mechanically propelled, it was not 'in motion'.

This was a decision of the House of Lords twenty-five years before the pronouncement of Lord Diplock, and no doubt has been cast upon it. Is the provision in the Factories Act ambiguous or not? 'Motion' primarily means movement; the machine was in movement, and therefore in the ordinary meaning of the phrase was in motion. The reason why the House of Lords cut down the meaning of the phrase must have been because the House did not believe that Parliament intended to cover the particular situation.

According to Lord Diplock, it is improper to do this if the meaning of the statute is plain. So the decision in the Factories Act case was justifiable only if the Act was regarded as not plain. But in what way was it not plain? 'In motion' is on its face, a reasonably plain phrase. Was not the reason why the House thought it not plain that their Lordships believed that Parliament did not have this situation in mind and would have cut down the wording if it had? Yet it seems that according to Lord Diplock, such reasoning is merely the invention of a fancied ambiguity, which is no reason for denying the 'plain' meaning of a statute." (p104-105)

Thus it appears that the literal rule is a rule against using common-sense. But why the seemingly favoured literal rule by the judges? Could it be that the judges were afraid of being accused of making political judgements at variance with the purpose of Parliament when it passed the Act?

8.3.3.6 FURTHER DEBATES

Other reasons advanced for the literal rule may be dialectically summarised here as argued by Williams (1982). Firstly, many statutes are passed by political bargaining and snap judgements of expediency: the Courts can rarely be sure that Parliament

would have altered the wording if it had foreseen the situation. This may be true, but is it any reason why the Courts should not do justice as best they can, leaving it to Parliament to intervene again if the decision does not meet with Parliament's approval?

Secondly, if Courts habitually 'rewrote' statutes in order to effect supposed improvements, this might cause statutes to become more complex in order to exclude judicial rewriting in a way that was politically unacceptable. This supposes that the Court misjudges what Parliament would wish it to do, whereas in fact the decision may win general approval. A Court that tries to decide as Parliament would have wished is more likely to be right than a Court that follows the words believing it was not what Parliament intended.

Thirdly, people are entitled to follow statutes as they are; they should not have to speculate as to Parliament's intention. This is a strong reason against the extensive construction of prohibitory legislation.

Fourthly, if Courts undertook to 'rewrite' statutes, this would tend to foment litigation, because it would encourage people who objected to the legislation to try their luck with the Courts. To suggest that the Courts will ever completely rewrite a statute is a great exaggeration, and even judges who accept the literal rule in words are likely to depart from it when the circumstances press them hard enough.

"Lord Diplock says that there may be differences of opinion as to what is expedient, just and moral, and that Parliament's opinion on these questions is paramount. This is obviously true, once Parliament's opinion is ascertained primarily from the words it has used. Nevertheless, the facts of the case may be such as to raise serious doubts whether Parliament intended its words to apply. The decision by a Court that a particular situation was not intended to come within the ambit of a statute, though within its words in what may be their most obvious meaning, does not deny the supremacy of Parliament. For if Parliament disagrees with the decision it can pass another Act dealing specifically with the type of case. It is not merely that Parliament fails to keep old law under continuous revision; it loses interest in its new creations as soon as they are on the statute book."

(Williams 1982, p106)

It appears that Parliament pays little attention to case law.

8.3.4 THE FUTURE

The 1969 Law Commission proposed that judges should adopt a 'purposive' approach to the construction of statutes, namely that a construction which would promote the general legislative purpose underlying the provision in question is to be preferred to a construction which would not. The general legislative purpose underlying the provision can emerge from a series of statutes dealing with the same subject matter and from other indications of Parliamentary information relating to legal, social, economic, political and other aspects of society, of which a judge is able to take judicial notice. Such judicial notice cannot be gleaned easily from the ordinary words used literally or even contextually from statute. A statute was seen by Langan (1969) as simply the 'will of the legislature' and this view it is submitted, remains sufficient, provided that it is understood that the will of the legislature must be expressed either by agreement of its three parts (Queen, Lords and Commons) or by the agreement by the Queen and Commons in accordance with the Parliament Acts of 1911 and 1949.

The purposive approach illuminates the policies derived from the legislative history and from the social background against which the Act was passed. Under the purposive approach, the judge may look beyond the four corners of the statute to find a reason for giving a wider or narrower interpretation to its literal words. His role then becomes one of active co-operation with the policy of the statute. But as documented in the micro purposive section, the purposive approach has never been popular with the Courts.

But things are changing. As stated earlier, the proposition that the purpose of the statute should be permitted to dictate its meaning has attracted little judicial support in this country; but the interpretive practices of the Court of Justice of the European Communities are increasingly held out as a model which Courts in the United Kingdom could follow. The appropriateness of this model depends on an accurate understanding of the present judicial system of statutory interpretation on domestic law, secondly, the European Communities Act 1972, thirdly, on the interpretive practices by the European Court of Justice and lastly on an appreciation of its implications for Courts in the United Kingdom.

8.3.4.1 THE PRESENT JUDICIAL STANDPOINT

There has been much criticism of the English principles of legislation. In particular, as highlighted earlier, too much use has been made in the past of the literal rule at the expense of a more purposive approach. The three so-called 'rules' - literal, contextual and purposive - are not rules at all since when compared with the judicial graph, there is no consistency of application. There is no set order of priority. In auditing case law, the Court will apply the literal rule in one case, while in another case it will reject the literal rule. To make it even more confusing, the Courts do not normally identify which rule it is applying. The presumptions may be similarly criticised. For instance, there is no rule about which presumption should be applied where two of them conflict. Some of the limitations on the use of extraneous material have been felt to be unduly restrictive.

The proposals of the 1969 Law Commission report on 'The Interpretation of Statutes' have not been implemented by legislation. The Law Commission was most impressed by the purposive rule but said that it needed to be adapted to modern conditions. It recommended the passing of a short statute setting out the extrinsic materials which the Court would be entitled to consider in interpreting legislation.

Attempts were made by Lord Scarman to secure legislation which would give effect to these proposals of the Law Commission, of which at the time of its report in 1969 he was the first chairman. Lord Scarman's attempts have failed owing to opposition from judges and laymen alike. In 1980, his Interpretation of Legislation Bill was withdrawn after opposition from his judicial colleagues in the House of Lords.

But some judicial efforts, notably by Lord Denning, have been made to improve the interpretive technique. Writing extra-judicially, Lord Denning (1979) agrees that the object of statutory interpretation is to discover the intention of Parliament. But he argues that the actual words used in the statute are only the starting point, and not the finishing point. He prefers the purposive approach to the literal approach. He is an intention seeker rather than a strict literal constructionist.

The purposive approach is the European approach to statutory interpretation and he recommends its extension to Acts of the United Kingdom Parliament. Lord Denning has

also aired his view from the bench in *Nothman v London Borough of Barnet (1978) 1 ALL ER 1243 at 1246*:

"The literal method is not completely out of date. In all cases now in the interpretation of statutes, we adopt such a construction as will promote the general legislative purpose underlying the provision. It is no longer necessary for the judges to wring their hands and say: 'There is nothing we can do about it'. Whenever the strict interpretation of a statute gives rise to an absurd and unjust situation, the judges can and should use their good sense to remedy it - by reading words in, if necessary - so as to do what Parliament would have done had they had the situation in mind."

When the *Nothman (1978)* case reached the House of Lords, Lord Denning's approach was criticised. In particular, his attempt, single-handed and without legislation, to implement the Law Commission's recommendations of 1969 was too much for Lord Russell of Killowen, who expressly disclaimed Lord Denning's 'sweeping comments'. Lord Denning's purposive approach to the interpretation of domestic legislation has received little judicial support.

However, the House of Lords has since said that a judge may adopt a purposive interpretation only if he can find in the statute, or in permitted extrinsic material, an expression of Parliament's purpose or policy [*Shah v Barnet London Borough Council (1983) 1 ALL ER 226*]. The judge is not permitted to interpret legislation in the light of his own views about policy. In essence, this represents a reaffirmation of the literal approach to statutory interpretation by which judges are positively discouraged from seeking to discover the policy underlying a piece of legislation. The only concession granted to judicial creation by the *Shah (1983)* case is that judges may adopt a purposive approach to interpretation if the purpose or policy of Parliament is discernible from the statute itself or from material to which they are permitted by law to refer as an aid to the construction of the statute.

The House of Lords is certainly moving towards a purposive approach in the interpretation of international conventions and treaties. In *Fothergill v Monarch Airlines Ltd (1981) AC 251*, Lord Wilberforce, Lord Diplock and Lord Scarman gave overt support to such a move. The purposive approach is also adopted by English Courts when interpreting European Community legislation. It remains to be seen what actual effect these developments will have on the interpretation of English domestic legislation and on the technique of Parliamentary draftsmen.

8.3.4.2 THE EUROPEAN COMMUNITIES ACT 1972

Secondly, s2(1) of the European Communities Act 1972 provides as follows:

"All such rights, powers, liabilities, obligations and restrictions from time to time created or arising by or under the Treaties, and all such remedies and procedures from time to time provided for, by or under the Treaties, as in accordance with the Treaties are without further enactment to be given legal effect or used in the United Kingdom shall be recognised and available in law, and be enforced, allowed and followed accordingly."

The result of s2(1) is that European Community law, whether arising from the Treaties or from Community regulations, and whether such law has already been made or is to be made in the future, is to take direct effect in the United Kingdom without the need for the UK Parliament to pass a statute each time. In addition, by s2(4) any 'enactment' (which is wide enough to cover a statutory instrument as well as a statute) passed or to be passed in the United Kingdom must be construed with European Community law in mind.

Thus the 1972 Act lays down that European Community law overrides existing domestic law whenever the two conflict and it lays down a presumption of interpretation that future United Kingdom statute law is to be read subject to European Community law. It is anticipated thereby that Parliament will not pass legislation which is inconsistent with European Community law.

8.3.4.3 ENGLISH vs EUROPEAN LAW

Thirdly, the English principles and techniques of interpretation are not suitable for the construction of European Community legislation. The latter is drafted in continental form, which is to state broad principles and leave the details to be filled in later by the judges, who are expected to promote the general legislative purpose. Lord Denning MR compared the English style and the style of the EEC Treaty in *H P Bulmer Ltd v J Bollinger SA (1974) Ch 401 at 425*:

"The draftsmen of our statutes have striven to express themselves with the utmost exactness. They tried to foresee all possible circumstances that may arise and to provide for them. They have sacrificed style and simplicity. They have forgone brevity. They have become long and involved. In consequence, the judges have followed suit. They interpret a statute as applying only to the circumstances covered by the very words. They give them a literal interpretation. If the words of the statute do not cover

a new situation - which was not foreseen - the judges hold that they have no power to fill the gap.

How different is this Treaty! It lays down general principles. It expresses its aims and purposes. It uses words and phrases without defining what they mean. An English lawyer would look for an interpretation clause, but he would look in vain. There is none. All the way through, the treaty, there are gaps and lacunae. These have to be filled in by the judges, or by regulations or directives. It is the European way."

Legislation in European form cannot be interpreted literally. Continental judges have to go further and adopt the purposive approach. The aim is to apply the 'spirit' rather than the 'letter' of the law. The Court of Justice of the European Communities has made it clear in its judgements that Community Legislation should be interpreted in this fashion [*Van Duyn v Home Office (1975) Ch 358, CJEC*]. The Court of Appeal in *H P Bulmer Ltd v J Bollinger SA (1974) Ch 401* has said, through Lord Denning M R (*at 425-6*) that English judges must do likewise:

"Beyond doubt the English Courts must follow the same principles as the European Court. Otherwise there would be differences between the countries. That would never do. All the Courts of (member) countries should interpret the (EEC Treaty) in the same way...likewise the regulations and directives..."

(The English Courts) must follow the European pattern. No longer must they examine the words in meticulous detail. No longer must they argue about the precise grammatical sense. They must look to the purpose or intent. They must divine the spirit of the Treaty and gain inspiration from it. If they find a gap, they must fill it as best they can. They must do what the framers of the instrument would have done if they had thought about it."

Later in *Macarthy's Ltd v Smith (1979) 3 ALL ER 325*, Lord Denning (*at 329*) went so far as to state that in interpreting a statute of the United Kingdom Parliament:

"(We) are entitled to look to the (EEC Treaty) as an aid to its construction, but not only as an aid but an overriding force."

When an English judge is interpreting Community Legislation, he must follow decisions and opinions of the Court of Justice of the European Communities. This is made clear by s3 of the European Communities Act 1972 [as amended by the European Communities (Amendment) Act 1986]:

"1) For the purposes of all legal proceedings any question as to the meaning or effect of any of the Treaties, or as to the validity, meaning or effect of any Community instrument, shall be treated as a question of law (and, if not referred to the European Court, be for determination as such in accordance with

the principles laid down by and any relevant decision of the European Court or any Court attached thereto.

- 2) *Judicial notice shall be taken of the Treaties of the Official Journal of the Communities and of any decision of, or expression of opinion by, the European Court or any Court attached thereto, on any such question as aforesaid.***

Section 3 of the European Communities Act 1972 itself must be read in conjunction with article 177 of the EEC Treaty. Under article 177, a judge at first instance and the Court of Appeal (unless its decision would be final in the case) have a discretion to refer any question of the interpretation of European Community Legislation to the Court of Justice of the European Communities for a ruling. The discretion arises if a decision on the question is necessary to enable the domestic Court to give judgement in the case. On the same conditions, the House of Lords must refer such a question to the European Court. When the European Court gives a ruling on the reference, its decision is then binding in that particular case. But it is not binding in future cases because the European Court is not bound by its own decision as in *Da Costa en Schaake NV v Netherlandse Balastingadministratie (1963) CMLR 224, CJEC*. This freedom from the rigidity of any strict doctrine of precedent is necessary to enable the European Court to take into account future policy considerations. It also means that if the House of Lords considers that an earlier decision of the European Court is wrong or unsatisfactory in some way, it can refer the point again to the European Court for reconsideration in a later case.

8.3.4.4 IMPLICATIONS FOR UK COURTS

Thus, the European Court of Justice is uniquely entitled to give authoritative and final rulings on the interpretation of Community law. Accordingly, its interpretive practices may be regarded in this matter, as a model for UK Courts. It has a three-fold approach which emphasises the inter-dependence of the purpose of Community law, the strategy adopted to give effect to it and the language in which it is cast. As Chevallier (1964) puts it:

"It is rare for an important judgement, settling a point of economic law, not to mention the opening Articles of the Treaty, which always enables the Court to view the case before it and the technical provision applying to it from a distance, and to elucidate facts and texts in the light of the objectives of the Community."

(p30)

The Courts 'basic' method of interpretation is thus first to ascertain the general objective which the authors of the Treaty set for the matter under consideration, and secondly to establish the legislative scheme which they devised for its implementation, both of which may involve consideration of the effectiveness of alternative interpretations. The process of ascertaining the purpose is facilitated by the statements which appear in the preamble to the relevant Article, whether of the Treaty, a Regulation or a Directive, while the scheme is established by examination of the legislative hierarchy employed in the case, for example, where the provision in issue was authorised by the Treaty directly or by a Directive.

Central to the Court's interpretive method, however, and what encourages the view that the purposive elements are to be within it, is that a text-based interpretation alone is never a sufficient reliable basis for its conclusion. The purposive and schematic elements are necessary concomitants of the primary objects of Community law and the Court will always seek to set text-based interpretations within the context provided by those elements.

The necessity for constant reference to the statutory purpose is one of the implications for the interpretation of United Kingdom legislation following from the suggestion that the Courts should emulate the interpretive practices of the European Court of Justice.

However, a much more fundamental feature of Community law is that there is no requirement that the disputed provision's words should be ambiguous before the Court can reject their natural and ordinary meaning in favour of an alternative meaning justified by reference to the legislation's purpose. In other words, while explicit consideration of the statutory purpose is necessary to confirm the literal or contextual meaning of the provision in issue, such consideration may equally displace it, even when its language is unambiguous.

Lord Oliver in *Pickstone v Freemans plc (1989) AC 66 at 112* said:

"I think, however that it also has to be recognised that a statute which is passed in order to give effect to the United Kingdom's obligations under the EEC Treaty falls into a special category and it does so because, unlike other treaty obligations, these obligations have in effect been incorporated into English Law by the European Communities Act 1972."

This dictum is important as a statement of the manner in which the judiciary may approach the interpretation of domestic legislation intended to give effect to Community law. Its significance lies in its implications for the judicial interpretation of statutes generally, if an interpretive method in which primacy were given to the purpose of statute became the norm. It entails the possibility that the natural and ordinary meaning of words which are unambiguous in their context will be displaced by a meaning derived from a consideration of the legislative purpose itself supported by a consideration of Parliamentary proceedings. If so, the purposive graph then shifts to become isomorphic with the judicial graph. This possibility is, for the moment, too far removed from the traditional understanding of the constitutional theory of judicial interpretation to be extended beyond the special case of Community law.

It should be remembered that since 1 January 1973, those revisions of European Community law which are directly applicable within member states have been sources of English law. The historical causes of this development include the accession of the United Kingdom to the Treaty of Rome and other treaties and the enactment of the European Communities Act 1972. Section 2(4) of that Act provides that any enactment passed or to be passed, shall be construed and have effect subject to the provisions of the section, which incorporate Community law into domestic law. There are three implications of the harmonisation of Community law into English law.

The first is that Parliamentary sovereignty has been limited. This has often been a constant reassertion by the previous Prime Minister, Mrs Thatcher. Any rule of domestic law which prevented Courts from giving effect to directly enforceable rights established in Community law would be bad. Bingham L J in *R v Secretary of State for Transport (1989) 2 CMLR 353 at 403* said:

"To that extent, a United Kingdom statute is no longer inviolable as it once was."

The Treaty of Rome and other treaties establishing the various communities become ultimate sources of English law. In the event of conflict between a rule of European law and a rule of domestic law, the former must prevail. Cross and Harris (1991) observed that no such conflict has yet emerged so far as English rules of precedent are concerned. It is just a matter of time before the conflicts are brought to the surface.

Secondly, the incorporation of European law has resulted in a radically new doctrine of statutory interpretation, according to which every Act of Parliament is to be construed in such a way as to avoid conflict with directly enforceable rights. Section 2(4) of the 1972 Act has precisely the same effect as if a section were incorporated in any enactment which in terms laid down that its provision are to be without prejudice to directly enforceable Community rights. Here EC law become derivative sources owing to their status as parts of English law to the enactment of the 1972 Act.

Thirdly, what is anticipated is that as more and more of the EC law (treaties, regulation, directives) are passed and become incorporated into the domestic law of UK, the judicial graph will be translated from the literal graph to the purposive graph. Britain's membership of the EEC reinforces that likelihood. The EEC Commission has been increasingly fertile in formulating proposals. In particular, the harmonisation of company law by means of directives will require implementation by member states. One may be faced with Companies Acts at more regular intervals in place of the comfortable old pattern of reform every twenty to thirty years or so.

The key to the opening of every law should and will be the reason and spirit of the law - it is the ANIMUS IMPONENTIS: the intention of the lawmaker expressed in the law itself, taken as a whole. Such a holistic view implies that to arrive at a true meaning of any particular phrase in a statute, that particular phrase is not to be viewed, detached from its context in the statute. It is to be viewed in connection with its whole context and that incorporates the purpose of the statute. It recognises the fact that the purpose is something to be taken into account in arriving at the ordinary meaning of a phrase or provision and not merely something to be considered only if any doubt arises from the terms employed by the legislature. The notion that the ordinary meaning of statutory words is something to be arrived at by a purely semantic process, or at most, with the aid of the other enacting parts of the statute in which they occur will be finally exorcised. The Courts should never shut their eyes to legislative history which provides useful evidence of the purpose of a statute, especially when the purpose is gradually to be accepted as part of the statutory context, in line with EEC law.

8.4 ENVOI

At this macro stage where the canons are put alongside each other, one can begin to sense the diversity of possible interpretations for a particular statutory provision. As

evidenced on the macro graph, the prospects for finding a universal meaning in such statutory provisions appear to be weak. Just as the interpretive community in literature has become so fragmented in the meanings of great literary texts, so is the problem facing the legal community.

It is such stark variations in the authority and weight ascribed to the modes of interpretation apparently by individual judges and in the results obtained in individual cases, that prompted Willis (1938) to say that a Court invokes whichever of the rules that produces a result which satisfies its sense of justice in the case before it. The traditionally low predictive utility of these modes has, on occasion, prompted the view that greater consistency of application, as well as a greater conformity to the intention of the legislature, would be achieved if, in the interpretation of legislation, the Courts accorded primacy to its purpose. Moreover, as Samuels (1980) puts it;

"The difficulty of interpretation of statutes is a facet of our constitutional, political, economic and social life and of institutions and attitudes."

(p86)

Posner (1990) argues that a statute is better understood not as a literary work but as a command of the sovereign.

He added:

"If we set aside the question of 'civilizing interpretations', the idea of a statute being a command issued by a superior body (the legislature) to a subordinate body (the judiciary) provides a helpful way of framing inquiry into the principles of statutory interpretation. Helpful because it enables us to shift our attention from the nebulous idea of 'interpretation' to the somewhat more concrete idea of communication, an idea that is obscure in the (literal) approach."

(p265)

Characterising a statute as a command makes it natural to think of interpretation in terms of ascertaining the drafters' wants, to which their words are only a clue.

Posner (1990) states that the more one thinks about interpretation in general, the further away one is carried from the important question concerning statutory interpretation, which is political rather than epistemic: how free should judges feel

themselves to be from the fetters of text and legislative intent in applying statutes. As the judiciary is subserviant to the Parliament, they do not have full discretionary power in interpreting statutory provisions. The issue is further aggravated when judges cannot consult the legislators, together with the lack of time, temperament and training to conduct a full-fledged investigation of legislative background and purpose - the sort of investigation a professional historian or political scientist might conduct.

Thus according to Posner (1990):

"when purposive interpretation fails, or when these techniques reveal simply that the matter in question has been left to the Courts to decide according to their own 'lights', statutory interpretation is transformed into judicial policy making, and the usual problems of judicial objectivity arise. This helps explain the enduring appeal of the (literal) approach; it avoids the uncertainties of interpretation. But it does so at a high price: that by refusing to take seriously the communicative intent, and broader purposes alike, of the legislators in the many cases in which that intent can be discerned, and of refusing to play a constructive role in the development of sound public policies in the remaining cases."

(p278)

Here it also raises the question of legitimacy - who has authorised the Courts to decide statutory cases when the meaning of the statute is vague. There is no concrete evidence that legislature wanted the judges to make up their own minds, that it wanted the Court to resolve it or that the Courts should accept the role of supplementary legislature.

The legislature may have had neither desire nor opinion as to whether the Courts should try to close the gaps and dispel the ambiguities in its handiwork. Whether a gap in legislation arises because the legislators lacked foresight or because they were unable to agree on how to close the gap or because they lacked the time to deal with the question or because they just did not care, does not dictate what attitude the Courts should take toward the gap. Cases where legislators explicitly delegate policy-making tasks to Courts are rare, so the difference between the accidental and the deliberate gap has little practical significance. In either case the Court must decide whether to fill it. If it does fill it, the Court will be exercising the kind of discretion that a common law Court uses to decide a question not ruled by precedent.

The interface between statute law and the auditor has been, is and will be an issue of intense concern in the world of professional practice. This interface will be accelerated with the impact of the present and future incoming EEC laws.

At one level the auditing profession is becoming more interdisciplinary reflecting developments in the substance of law and auditing. At another, fundamental differences exist between the Courts and auditors which have their basis in varied historical and constitutional or cultural roots. The tensions arising from these conflicting levels of development will be mushroomed when the real force of the EEC law begins to hit upon the domestic law head on, increasing not only points of contact but also the opportunities for collision and conflict, thus forcing a change in the directions of development. Statutory interpretation in the UK is progressing towards a transformation in response to domestic and European pressures, with corporate failures providing further stimulus for reform and clarification of the auditor's statutory duties towards fraud detection. On the latter point, it would be fascinating if a case reaches the European Court for clarification, especially in the context of fraud detection.

The last two chapters have sought to deal with statute company law (using the framework of the auditor's duties towards fraud detection) as it functions in society and to include in its analysis and interpretations, those branches of emergent meanings in which statute law is an important but not the only factor affecting the auditor's duties. The tensions arising from these conflicting levels of statutory interpretation and the associated dynamics for change have been underlying focus of this study. It was made clear that much work was necessary to clarify the differences in the interpretation of the statutory duties and to explain or reconcile the gaps in their coverage. One might even go so far as to say that in the coming years it will become impossible to reflect upon auditing, UK company law and EEC law in isolation from one another.

This proximity is evident not merely at the level of substantive development in company and the regulation of auditors under the EEC law, but also has much to do with the removal of 'boundaries' in Europe, the changing nature of the legal and auditing professions and their claims to expertise on behalf of clients, regulators and the wider public.

The new regime for regulating auditors in the 1989 Companies Act is the result of the implementation of the EC Eighth Directive rather than a direct response to events. For

auditing is largely a by-product of the law and its process. Auditing gained its prominence when the audit became compulsory back in 1844. Even if its efficacy sometimes seems no less questionable today than it was at the time of its inception, the audit still survives as the agency charged with fraud detection to a greater or lesser degree, depending on whose perspective one is adopting. An emerging confidence in the legitimacy of auditing has also encouraged the profession to seek an independence from its legal origins. Over time, this has inevitably given rise to tensions and frustrations, especially when the auditing professional guidelines issued is at variance with the various interpretations of statute law. It is possible that the profession may have attempted to inject objectivity and certainty into an area too important to be left to 'subjective' interpretations.

We now move to the next chapter: conclusion, where some of the final thoughts are documented.

CHAPTER 9

CONCLUSION

9.0 PRELUDE

"Ideas occur to us when they please, not when it pleases us. The best ideas do indeed occur to one's mind in the way in which Ihering describes it: when smoking a cigar on the sofa; or as Helmholtz states of himself with scientific exactitude: when taking a walk on a slowly ascending street; or in a similar way. In any case, ideas come when we do not expect them, and not when we are brooding and searching at our desks. Yet ideas would certainly not come to mind had we not brooded at our desks and searched for answers with passionate devotion."

Weber (1958), p136

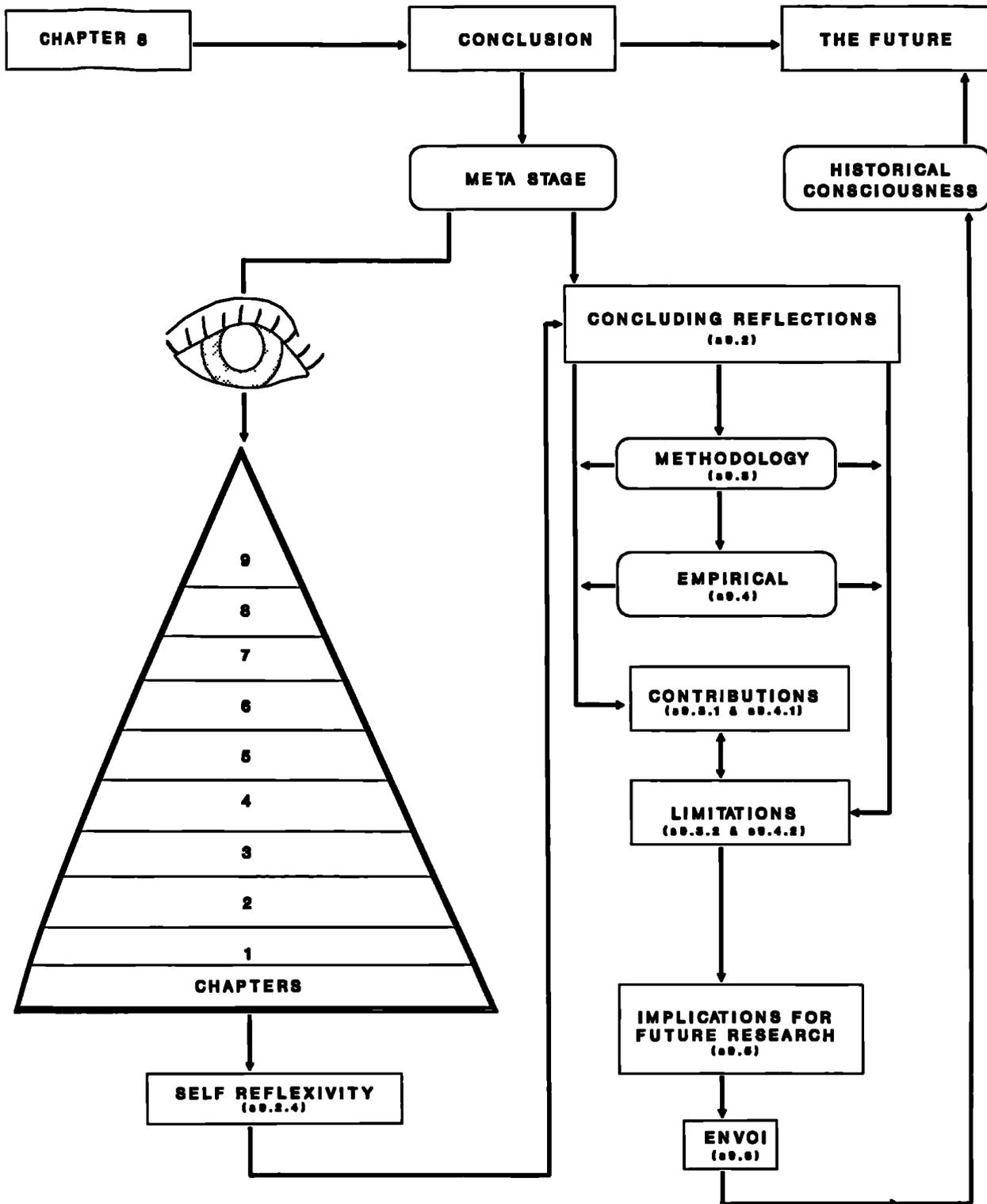
9.1 INTRODUCTION

In this final chapter, the process of reflexivity is carried out. It is as if one was now standing on the mountain top, gaining the height and perspective to look down and to the encompassing vast horizons set before him or her. It creates the opportunity to stand back for a while and to cast an evaluative mind to all that has gone before in the preceding chapters.

This chapter begins with some further concluding insights to be gained, a meta stage perhaps, touching on some very broad issues in statutory interpretation, statute law and self-reflexivity. Whilst the concluding reflections and salient points sections will re-highlight briefly the conclusions from the previous chapters 6, 7 and 8, it will not summarise again in detail all the findings there, in view of redundancy. Otherwise, it would make this chapter even longer. The detailed findings of this research can be found in the sub conclusion and concluding sections in those respective chapters.

As seen in Figure 9.1, it then moves on to an evaluation of the methodology and the empirical work carried out on this research, both in terms of its characteristic significance or contributions followed by an acknowledgement of its limitations or qualifications. Finally, the implications for future research will be highlighted.

Figure 9'1: FRAMEWORK OF CHAPTER 9



9.2 CONCLUDING REFLECTIONS

9.2.1 COMPANY LAW AS THE SURROGATE BASIS

The interjection of final insights on statutory interpretation and statute law have been evolved by induction from observations of the regulation of audit in company law. Whilst it is appreciated that the danger associated with the process of inductive logic reasoning is that the premises contained in the original proposition may not be sufficient to guarantee the conclusion, it is argued that there is still some valuable insights to be gained because of the deep seated representation of company law as a form of statute law.

Whilst the ideal situation would be to study all the statutory laws of this country, it is questionable whether such a massive undertaking would be necessary to justify such insights. It would be economically an unreasonable and unrealistic undertaking in the context of the incremental knowledge to be gained. Company law was thus used as the surrogate basis for statute law in the comments and interpretations..

9.2.2 REFLECTIONS ON STATUTORY INTERPRETATION

9.2.2.1 THE NEED

The function of the judges in relation to legislation is to apply it. If however, the wording of the legislation is ambiguous, or its extent uncertain, its meaning or scope will need to be interpreted or construed first. Legislation is expressed in words and words as we have seen are an imperfect and inadequate means of communication. Legislation may need interpretation because for example, the Act is badly drafted or because the subject matter of the Act is so complex that errors are inevitable, or because the Act fails to provide for all possible contingencies.

So if the words are capable of more than one meaning, it is a perfectly legitimate intermediate step in construction to open up and discover potential meanings by various rules (literal, contextual, purposive, judicial) which can throw light on what the draftsman meant to say. It was discovered, especially in the context of audit legislation extended to the wider statute law, that there will always be a seat reserved for statutory interpretation.

9.2.2.2 THE DANGERS

But judges in their duty to society have in some aspects of their interpretive role, a discretionary power to do justice so wide that they may be regarded as lawmakers. It has been said that whenever judges pretend they are discovering the intention behind some piece of legislation, it is simply a smoke-screen behind which the judges impose their own view of what the statute should have been (Dworkin, 1982). It is debatable whether in adopting an interpretation, the Court is making law. It depends on what one means by 'make' and 'law' in this context. What is incontestable is that the Court is a mediating influence between the legislature on the one hand and the citizen on the other.

The common law and equity, both of them in essence systems of private law, are fields subject to the increasing intrusion of statute law, where society has been content to allow the judges to formulate and develop the law. The judges, even in this, their very own field of creative endeavour, have accepted in the interests of stability and certainty, the self-denying ordinance of stare decisis, the doctrine of binding precedent. No doubt judicially imposed limitation on judicial lawmaking has helped to maintain confidence in the stability, certainty and even-handedness of the law.

But in the field of statute law, the judge must be obedient to the will of Parliament as expressed in its enactments. In this field, Parliament makes and unmakes the law. The judge's duty is to interpret and to apply the law, not to change it to meet the judge's idea of what justice requires. Interpretation does, of course imply in the interpreter a power of choice where differing constructions are possible. But the law requires the judge to choose the construction which in his judgement best meets the legislative purpose of the enactment. If the result be unjust but inevitable, the judge may say so and invite Parliament to reconsider its provision. But s/he cannot deny the statute. Unpalatable statute law may not be disregarded or rejected, merely because it is unpalatable.

Within these limits, judges have a genuine possible creative role. Great judges, like Lord Denning, are in their different ways judicial activists. But the Constitution's separation of powers, or more accurately functions, must be observed if judicial independence is not to be put at risk. For if people and Parliament came to think that

the judicial power is to be confined by nothing other than the judge's sense of what is right, confidence in the judicial system will be replaced by fear of it becoming uncertain and arbitrary in its application. Society will then be ready for Parliament to cut the power of the judges. Their power to do justice will become more restricted by law than it need be, or is today.

9.2.2.3 DISEMBODIMENT

In life, if A says something that B does not understand, B can ask A to explain what he means. This facility is not available in the interpretation of statutes. Individual Members of Parliament cannot be questioned as to what they mean by the statutory words that they have enacted. Hence, once a statute reaches the Royal Assent stage the statutory provisions are finalised and they carry a sort of disembodied or dehumanised meaning which Posner (1990) refers to as not necessarily the meaning intended by any actual person in particular, but the meaning that is conventionally attached to such words. This further complicates the process of statutory interpretation.

9.2.2.4 THE CHANGE

The prevailing judicial mode of interpretation tends to be predominantly literal. The proposition that the purpose of the statute should be permitted to dictate its meaning has attracted little judicial support in this country; but the interpretive practices of the Court of Justice of the European Communities are increasingly held out as a model which Courts in the United Kingdom could follow.

But at the end of the day it should be noted that the European Communities Act 1972 will continue to send rippling waves in forcing the change in the direction of the history of UK law, particularly in the area of statutory interpretation towards a purposive approach.

But perhaps the most meaningful and feasible rules for the interpretation of statutes are those suggested by common sense and the prevailing social and political ethos at its time of application.

9.2.2.5 THE EXPECTATION GAP

Though it was not the main aim of this research, it was highlighted in Chapter 2 that this study will touch on the hypothesis that the wording of the statutory documents per se represents an invisible contribution to the expectation gap.

For after all, what is the expectation gap but the gap that exists between what the public believe the auditors do (or might do) and what the auditors actually do. And on both sides, where does the expectation of the auditor's duty come from, if not from statute, case law, professional pronouncements, under a contract or in tort? Let us focus on statute, which is the chosen context of study.

It is argued here that the doubts and uncertainties manifested in the statutory interpretation of the audit have been a silent contribution to this gap. Whilst explanations have attributed it to a performance gap, or a standards gap or a liability gap, it is suggested that there should be a place for an 'interpretation gap' in its list of suggested possible causes.

It is not too difficult to envisage that where both or either the public or the auditor misinterprets the auditor's statutory duties, then the expectations will mismatch and a gap will inevitably emerge. If that is the case, then perhaps the focus should also be on the level of determinacy or indeterminacy of the statutory wording in the Companies Acts rather than putting the blame solely on the parties themselves.

The comprehension of the statutory duty is always assumed or taken to be unproblematic because the term 'fraud detection' does not appear explicitly on the statute book. But it was seen that where an explicit duty to detect fraud is not evident, the duty can still emerge indirectly by way of implication. And it is the later form of emergence that is most often ignored because of its subtleness and lack of literal expression but it is asserted that it is an area that needs to be explored in any research on the expectation gap.

Following from this, the phrase of 'the expectation gap' is challenged. Namely, that the word 'expectation' is framed in the singular sense. It implies that there is one singular absolute expectation gap. It is argued that within the public, there are differing perceptions of what the audit is, even within a similar class of people. Again, it is

suspected that the auditors would also come up with different perceptions of the audit too. The possible permutations emerging on the basis of statute and when extended to case law and professional pronouncements would be unimaginable.

Hence, it is argued that there is no one expectation gap but possibly many expectations gaps, which may explain partly why the problem has not been resolved despite the successive committees and inquiries which have investigated the gap and offered wide recommendations for its reduction.

The problems and complexities of statutory interpretation need to be associated with 'the expectation gap' dilemma.

9.2.2.6 SUB CONCLUSION

Thus, the failures of communication in reducing the expectation gap may be as much epistemological in origin as a simple function of the indeterminacy of the law. This has been a significant and largely invisible obstacle to those who wish to solve the problems of the expectation gap within existing regulatory structures.

In addition, the proliferation of canons of statutory interpretation suggests a perceived need to close the 'interpretation gap'. But there is no fundamental coordination in the perspectives of Parliament, the Courts, the auditors and the users and wider public in this process. On the contrary, there are systematic incentives to exaggerate the differences. More generally, the detailed 'definitional' interpretations have brought out the possible diversity of meanings. Over time, this has inevitably given rise to tensions and frustrations and case law has stepped in to inject some 'objectivity' and 'certainty' into areas too important to be left to subjective judgement. For after all, the auditing profession in Britain is largely a by-product of the law and its process. The professional role of auditors cannot be separated from the central context of law.

This study has sought to provide a platform for the analysis of these issues and in doing so, it may constitute a modest step towards mutual comprehension. Inevitably, the composition of the study says much about the existing institutional, constitutional and cognitive modes of demarcation between the canons of statutory interpretation. Yet as recognised towards the end of Chapter 8, these boundaries are presently subject to radical pressures for change from EEC law. It is predicted that the change will be

very slow forthcoming. Though the single European Act of 1986 requires the harmonisation of all relevant legislation to be passed by 31 December 1992, all that has really happened is much 'paper flying' only. But as the economic barriers are geographically removed, it is inevitable that the harmonisation of the law will have to follow suit in all the EEC countries, including the UK.

9.2.3 REFLECTIONS ON STATUTE LAW

9.2.3.1 THE IDEAL vs OBSERVED FACTS

When we observe the application of statute law more closely, we see that it is not as ideal as it seems. There are problems with the Courts applying it purposively, in obeying it reverently, establishing clarity and specificity.

9.2.3.1.1 THE LAW (PURPOSIVE) vs THE COURTS (NON-PURPOSIVE)

There are countless rules, cultural habits, and various kinds of social compulsions in every society, often called 'law'. The fundamental principles of 'law' do not always represent what we do, but what we ought to do. Similarly the science of the law is not the method which judges actually use, but the method which they ought to use.

Hence no-one should be surprised when there is so little similarity between the ideals of statute law (purposive) and what the Courts actually do (non-purposive). Is it possible that part of the function of statute law is to give recognition to ideals representing the exact opposite of established conduct? Most of its complications arise from the necessity of pretending to do one thing while actually doing another. This is so clearly seen from the 'acclaimed' application of the 'intention of the Parliament' by the Courts when there was very little evidence to support this probity.

9.2.3.1.2 OBEDIENCE vs REVOLT

The principles of law are supposed to control society, because such an assumption is necessary to the logic of the ideal. The statutory audit has been used as a weapon to control fraud. Yet an observer may view that the function of law is not so much to guide society, as to comfort it. Belief in fundamental principles of law does not necessarily lead to an orderly society. Such a belief is as often at the back of revolt or

disorder. Everyone should respect and obey the law in this country even if they do not like it. But no-one should be hindered or prevented from relying on his or her constitutional rights, and if this involves disobeying mere statutes, the act of disobedience intended for this purpose is most praiseworthy. Thus the law at the same time contains both the contradictory philosophies of obedience and revolt.

9.2.3.1.3 FOR THE LAWYER OR LAYMAN?

The general problem of clarity appears to be a perennial one. Does the fault lie with the draftsman or the subject-matter or something else? Intelligibility is a relative matter. What is important is that the statute should be clear to those who are most concerned with it, and account must be taken of the changed nature of law.

In the 19th century, law was predominantly made for lawyers. Indeed, as noted by Mitchell (1958), measures which reduce general intelligibility were welcomed then. There was little complaint because lawyers work the legislation and lawyers know their language. Today, most legislation is not made for lawyers. It is made for the egg-farmer, the chemist, the auditor, the shareholder, and what matters is that it should be intelligible to the technician and the layman, not the lawyer. Thus the criticism that consultation in the preparation of statutory instruments does not produce clarity may often be beside the point. Often the objects of consultation is to secure efficiency, and efficiency for the purposes of the lawyers may well be incompatible with clarity for the layman. Yet agreement with the words does not always include agreement on the meaning to be given to them. Statute law can be couched in language open to all sorts of meanings so that the persons to whom they apply cannot know whether they are acting legally or not unless possibly, they get counsel's opinion or at least a solicitor's advice. Even then, the Courts can overrule the opinion or advice in its judicial interpretation.

9.2.3.1.4 THE GENERAL vs SPECIFIC RESOLUTION

What is at issue here is the question of how far law can provide for its own proper application by establishing rules, criteria or principles that could offer guidance to its users in specific cases. On the one hand, such rules should need to operate at a high level of generality corresponding to the ethical truth claims vested in the notion of absolute justice. Laws that is to say, have application or practical warrant only to the

extent that their language is taken to possess referential force to fit the facts of some particular case in hand.

On the other hand, they would have to come to terms with the fact that no such abstract decision procedure could possibly encompass the various instances, facts or case histories which might be taken as falling under the law in question. This is because laws also lay claim to a universality, a respect for the standards of absolute justice that transcends each and every such localised instance.

Thus the principles of justice will always be couched in a language of the utmost generality which nevertheless allows for numerous conflicting and problematic interpretations.

9.2.3.2 SYMBOLS FOR THE 'WEAK' vs THE 'STRONG'

Nevertheless, statute law is primarily a great reservoir of emotionally important social symbols. It develops as language develops, in spite of, and not because of grammarians. Though the notion of a 'rule of law' may be the moral background of revolt, it ordinarily operates to induce acceptance of things as they are. It does this by creating a realm somewhere within the mystical haze beyond the Courts, where all our dreams of justice in an unjust world come true. Thus in the realm of company law, the external shareholders are comforted by the fact that through the audit, the management is accountable to the shareholders, ie the 'strong' has no advantage over the 'weak'.

Legislative law offers protection from arbitrary power in any environment without regulations, such as those easily exercised by management. It attempts to give all the social parties in commerce an equal chance of success, and at the same time as with the statutory audit protects the unprotected shareholder from those responsible, but in favoured positions of privilege and power such as the directors and management. From a practical point of view, the statutory audit represents an instrument towards commercial and social stability because it recognises the yearnings of the fears of the underprivileged, detached shareholders from their investment and gives them a forum in which those yearnings can achieve official approval and comfort through law.

But, statute law is elastic, growing and changing. When the Government adopts a caveat emptor policy, the wise are treated better than the foolish and that careless

people are punished for their mistakes. When the laissez faire ethos predominated in the 1856 Act by making the audit voluntarily, the shareholder takes heart by learning that company law ignores the more profitable forms of dishonesty in deference to the principles of individual freedom and caveat emptor from governmental restraint.

9.2.3.3 THE STRUGGLE TO UNDERSTAND AND DEFINE

Statute law can never be completely understood and defined. However, it should be said that one must never give up the struggle to understand and define law, in spite of all its imperfections and constant state of flux. Hence, the intellectual expenditure necessary for the upkeep of understanding the statute law should be maintained.

9.2.3.4 SUB CONCLUSION

Statute law represents the belief that there must be something behind and above government without which it cannot have permanence or respect. The abstract ideals of the law require for their public acceptance symbolic conduct of a very definite pattern by a definite institution which can be heard and seen. In this way only, can they achieve the dramatic presentation necessary to make them moving forces in society. Any abstract ideal which is not tied up with a definite institution or memorialised by particular ceremonies, becomes relegated to the limbo of metaphysics and has little social consequence. The institutions which provide law with that atmosphere of reality and concreteness so necessary for its acceptance are the Courts and Parliament. The prior produces the ceremonial ritualistic trial; the latter produces the legal instruments. In other words, trials today are the product of Courts; statutes the product of Parliament.

The law consists of a large number of mutually contradictory symbols and ideals. It is a myth that the law is moving towards certainty but what is found is the counter movement towards uncertainty. Such contradictions become apparent as shown in this study where one becomes immersed in the statutory and judicial process. S/he needs to believe, if s/he is to keep his/her faith that government is symmetrical and rational, that there exists somewhere, in one's struggle to understand and define, a unified philosophy of the science of law.

9.2.4 REFLECTIONS ON SELF-REFLEXIVITY

9.2.4.1 UNDERSTANDING IS BEING

As a research task, understanding includes a reflexive dimension from the very beginning. Understanding is not a mere reproduction of knowledge, that is, it is not a mere act of repeating the same thing. Rather understanding is aware of the fact that it is indeed an act of repeating; a reknowing of the 'known'. The operation of the understanding requires that the unconscious elements involved in the original act of knowledge be brought to consciousness.

The way of emancipatory understanding is a kind of unavoidable detour that the person who understands must take, leading to a 'wandering in the wilderness', whereby it involves a momentary 'loss of self'. For Heidegger (1962), the real question is not in what way being can be understood but in what way understanding is being, for the understanding of being represents the existential distinction. Understanding hence cannot be grasped as a simple activity of the consciousness that understands, but is itself a mode of the event of being.

In the last analysis, all understanding is self-understanding, but not in the sense of a preliminary self-possession or of one finally and definitively achieved.

Understanding is essentially a self-transposition or imaginative projection whereby the knower negates the temporal distance that separates him from his text (object) and becomes contemporaneous with it.

9.2.4.2 UNDERSTANDING IS DIALECTIC

The dialogical character of epistemological conversation begins when the researcher genuinely opens himself to the text by listening to it and allowing it to assert its viewpoint. Genuine questioning always involves a laying open and holding open of possibilities that suspend the presumed finality of both the text's and the researcher's current opinions. We understand the subject matter of the text that addresses us when we locate its question. In our attempt to gain this question we are, in our own questioning, continually transcending the historical horizon of the text and fusing it with our own horizon, and consequently transforming our horizon.

The understanding of a text has not begun at all as long as the text remains mute. But a text can begin to 'speak'. When it does begin to 'speak', however, it does not simply 'speak' its word, always the same, in lifeless rigidity, but gives ever new answers to the person who questions it and poses ever new questions to him who answers it. To understand a text is to come to understand oneself in a kind of dialectic dialogue. This contention is confirmed by the fact that the concrete dealing with a text yields understanding only when what is said in the text begins to find expression in the researcher's own language.

9.2.4.3 UNDERSTANDING IS LANGUAGE

It is no accident that despite the diversity of themes, language is the medium in which past and present actually interpenetrate. Understanding as a fusion of horizons is an essentially linguistic process; indeed, these two - language and understanding of transmitted meaning - are not two processes, but are one and the same. Since our horizons are given to us pre-reflexively in our language, we always possess our world linguistically. Word and subject matter, language and reality, are inseparable, and the limits of our understanding coincide with the limits of our common language. For Wittgenstein (1971) said:

"The limits of my language mean the limits of my world."

(p115)

Hence understanding is essentially linguistic, but in such a fashion that it transcends the limits of any particular language, thus mediating between the known and the unknown.

9.2.4.4 UNDERSTANDING IS INTERPRETATION

The whole of being that is mirrored and disclosed in language - including the language of texts - gives interpretation its continuing task. Interpretation belongs to the essential unity of understanding wherein meaningful interpretations emerge when we gain understanding. The infinity of the unsaid that is essential to language cannot be reduced to propositions that is to the merely, present-at-hand, for every new interpretation brings with it a new 'circle of the unexpressed'. Thus what is disclosed in language poses ever new questions to its interpreters and gives new answers to

those who are challenged by it and plays its meaning further within the dialectic of question and answer.

But the distinction between meaning and significance is at best difficult to apply to the history of interpretation, for it is undisputably the case that interpreters in different historical eras differed in what they thought they saw in the text and not just in their views of the significance of the same textual meaning for themselves. Thus there is no decreed interpretation of a text; rather, they stand open to ever new comprehensions.

9.2.4.5 UNDERSTANDING IS TAINTED

But the researcher's own present situation can affect this epistemological inquiry. As the source of prejudices and distortions that block valid understanding, it is precisely what the researcher must try to transcend. Understanding is the action of subjectivity purged of prejudices and it is achieved in direct proportion to the researcher's ability to set aside his own horizons by means of an effective methodology.

This methodological alienation of the researcher from his own historicity has been Gadamer's criticism. Is it the case, that the researcher can simply leave his immediate situation in the present merely by adopting an attitude? Gadamer (1977) claimed that our prejudices do not cut us off from the past, but initially open it up to us. They are the positive enabling condition of historical understanding commensurating with human finitude. For Gadamer takes the researcher's boundness to his present horizons and the temporal gulf separating him from his object, to be the productive ground of all understanding rather than negative factors or impediments to overcome.

9.2.4.6 SUB CONCLUSION

Our understanding is not necessarily free of presupposition and prejudice. For while the researcher may free himself or herself from this or that situation, s/he cannot free himself or herself from his/her own facticity, from the ontological condition of always already having a finite temporal situation as the horizon within which the beings s/he understands have their initial meaning for him or her.

9.2.5 CONCLUSION

The literature of jurisprudence performs its task most effectively for those who encourage it, praise it but do not read it or critically examine it. For those who study it in depth today, it is nothing but a troubling mass of conflicting ideas. However, it is not generally read so that its troubles are known only to the few people who read it for the purpose of writing more of it. For most of those who do not close their minds or reverence the law blindly, the vision if not the knowledge that there is a constant struggle to understand and define is vital in spite of our subjective bias.

9.3 METHODOLOGY

The comments here are based on the research model designed here called EISI which joins the symbolic interactionist approach with the interpretive, phenomenology and tradition associated with dialectical hermeneutics.

9.3.1 CONTRIBUTIONS

9.3.1.1 FAIRLY ORIGINAL

The EISI model (see Figure 4'3) is a qualitative methodology designed to depict the research as a building block process, going through the orders of study (H_1 , H_2 , H_{3a} , H_{3b}) as representing the levels of knowledge that build or layer on the previous order.

It is a dynamic model which starts from an objective high resolution domain of H_1 (data collection) and moves to a low resolution subjective domain of H_{3b} (macro stage). This embracing of both domains provides a concrete base (at H_1 and H_2) for the subjective interpretations emerging at level H_3 (micro and macro stage).

The EISI process consists of 6 key phases, starting from framing, contextualisation, capture, bracketing, construction and consolidation. Of these, the ideas for the framing, capture, bracketing and construction stages were triggered off by Denzin (1989). Other than this point the rest of the model, including the title was originally designed. It is also the first time that such a model is applied to the subject area of the statutory auditor and fraud detection.

9.3.1.1.1 GENERAL APPLICATION

Though designed with qualitative research in mind, it could be argued that the framework could be applied generally to other quantitative research where questions need to be framed, the context set, data captured, the analysis bracketed and conclusions constructed and consolidated.

9.3.1.2 METHODOICAL

Here the EISI model is methodically constructed and clearly set up, starting from framing to consolidation. For it is only through using an explicit model clearly showing the stages in the framework that other researchers are able to adopt systematically, to examine the validity of the procedures adopted here and to see whether the conclusions one has drawn are in fact justified. This contrasts with some of the other interpretive approaches, eg Foucauldian which portrays a rather elusive, unclear procedural framework.

9.3.1.3 EPIPHANIC

Douglas and Johnson (1977) and Kotarba and Fontana (1984) argued that the rather considerable social science literature and qualitative research methods do not contain any extended treatment of the 'interpretive' existential point of view. Nor is there any serious or rigorous account that applies this perspective to the study of turning point moments or epiphanies in the lives of interacting individuals. The present EISI model attempts to fill this void.

As a distinctly qualitative approach to social research, EISI attempts to make the world of lived experience directly accessible to the reader. EISI allows the focus of those life experiences on the epiphanic points that radically alter and shape the meanings persons give to themselves and their environments. This existential thrust (Sartre, 1956) sets this research methodology apart from other interpretive approaches that examine the more mundane, taken-for-granted properties and features of everyday life.

A methodology of this order can produce meaningful descriptions and interpretations of social processes. It can offer explanations of how certain conditions came into existence or persisted or disappeared. The epiphany does furnish the basis for realistic

proposals concerning the improvement or removal of certain events, or problems (Becker and Horwitz, 1986). This mode of research may also expose and reveal the assumptions that support competing definitions of a problem (Becker, 1967).

9.3.1.3.1 TEMPORAL MAPPING

The researcher must connect dates to events to produce a temporal mapping in the form of graphs. It involves the capture and bracketing phase of EISI which has two interrelated processes: (1) determining the temporal sequencing and organising of events in the setting, and (2) locating dates and events in space - that is, where are these interactional situations located. The essence of history lies in the fact that by definition there needs to be a chronological guiding thread locating events in space and time to produce a historical picture.

Temporal mapping focuses on who does what, with whom, when and where. The process of mapping on EISI is important for several reasons.

First, unless, the researcher knows how the processes to be studied are distributed through the social structure s/he risks studying atypical or unrepresentative instances of the phenomena.

Secondly, mapping builds a historical dimension into the research act. Every individual studied has a historical, biographical relationship to the event, crisis or problem under investigation.

Thirdly, the sites that are studied - have their own histories within the social structure. Thus history has two dimensions. Firstly, sites have histories with other sites. Secondly, sites have their own histories (ie when they were established and so on).

Fourthly, with the temporal mappings are produced, it is easy to identify the epiphanies on the graph which alerts the researcher to unique cases which might otherwise be ignored.

9.3.1.4 INTERPRETIVE

As EISI works within the 'interpretive' framework, it tends to go about the study on the auditor and fraud detection in a totally different way. Since the aim is to start from one's appreciation as ordinary human beings of the social phenomena one is studying, one tends to see prior hypotheses about the phenomena more of an impediment than help. As discovered from the past empirical research studies conducted in this area (see s3.4), most of the research on this subject has adopted a quantitative positivistic approach. The creation of EISI is an attempt to redress this imbalance.

Because EISI is qualitatively non positivistic, one does not have to spend time arguing against or disproving traditional notions but to proceed directly to offer an alternative construction of the confronting elements. It does not suffer from problems of questionnaire surveys such as low response rate or misinterpretation of the questions and of subjects giving the answers that they think are expected. Such is the intellectual emancipation which the EISI model so strongly advocates.

In EISI one tries therefore to become involved in the situation one is seeking to interpret and pursue an understanding of it through learning or rediscovering what other people involved in the activity or situation might understand about it. EISI at the H₃ level, deepens and expands one's direct appreciation of the situation by whatever means it is possible.

Denzin (1982) argued that thin descriptions and interpretations abound in the social sciences. They find their expression in correlation coefficients, dummy variables, structural equations, statistical tests of significance. Indeed, a great deal of interpretive theory in the social sciences is based on thinly described materials (Denzin, 1989). The result has been too much theory and not enough description. The heart of EISI lies in thick description, thick interpretation and deep authentic understanding. It will require an ability to think comparatively, historically and interactionally. It will also dictate a consideration of the micro-macro power, gendered relations that exist in the context that is being studied. This concern for power and how power twists and shapes human experience gives interpretive research a critical thrust that is often absent in conventional research studies.

In a certain sense, interpretive studies hope to understand the subject better than they understand themselves (Dilthey, 1976). Often interpretations are formed that subjects would not give to their actions. This is so because the researcher is often in a position to see things the subject cannot see. The full range of factors that play on the individual's experience is seldom apparent to them. The interpreter has access to a picture of the subject's life that the subject often lacks.

9.3.1.4.1 CONTEXTUAL

In the world of societal perspectives, interpretation in a context is seen as a key feature in giving contained meanings to history. Unless the context is set, the effect on subsequent interpretations can remain clouded and possibly misunderstood.

The EISI model provides for the context to be set explicitly. The aim is to bring into a specific and sharper focus on the phenomenon or subject under investigation. It will also assist in the creation of a contextual body of materials that will furnish the foundations for interpretation and understanding. When we seek to interpret in a context, we are trying to make more precise our comprehension of some specific and delimited area and becoming more exact about what is known. The stipulation for an exploited context provides the research territory and contains the accounts of problematic meanings in the relational world of the subject.

9.3.1.4.2 IMAGINATION

Gadamer (1975) pointed out that the differentia between methodological sterility and genuine understanding is imagination, that is, the capacity to see what is questionable in the subject matter and to formulate questions that question the subject matter further. And the precondition of this capacity is that one is open to be questioned by the text, to be provoked by it, to risk involvement in a dialogue that carries one beyond one's present position.

The EISI model allows the opportunity to train the mind to possess the sociological imagination to raise questions which touch on the intellectual pivots of classic studies of man in society. For that imagination is the capacity to shift interactively from one perspective to another - from the political to the economic; from the examination of the micro view to a macro view, from the auditor to the Government. It allows the

capacity to range from the impersonal and remote transformation to the intimate features of the human self - and to see the relations between the two. Behind the outward manifestation, there is always the thrust to know the social and historical meaning of an event in the society and in the period in which it has its quality and being.

It attempts to grasp what is going on in the world, and to understand what is happening in themselves as minute points of the intersections of biography and history within society. In part, contemporary man's self-conscious view of himself, at least as an outsider, if not a permanent stranger, rests upon an absorbed realisation of social relativity and of the transformative power of history. EISI attempts to bring out this fruitfulness of self-consciousness via granting research space for imaginations in the construction (H_{3a}) and consolidation (H_{3b}) stage.

In construction and consolidation, its contributive field of application comprises all those situations in which we encounter meanings that are not immediately understandable but require interpretive effort. It has to do with bridging the gap between the familiar world in which we stand and the strange meaning that resists assimilation into the horizons of our world. What the text really means is not at all what it 'seems' to say to us directly. Rather its meaning must be recovered by a disciplined construction and consolidation of the historical situation of life-context in which it originated.

9.3.1.5 SYMBOLIC

Language in particular was used in EISI as the fruitful route to one's appreciation of the social phenomena and symbols of any type may further provide the researcher with insights into the way in which apparently unrelated aspects of events (eg statutory regulation) are in reality connected. The end result of the analysis is an interpretation of the social phenomena under study which makes sense to the outside world and reveals subtleties and insights, and connections, which hitherto had remained obscure or even unobserved. The emphasis is on making apparent a pattern of relationships amongst what were formerly seen as unconnected elements in statute law.

EISI sees language as the gateway to the inner interpretative structures of the subjects that are being studied. First, it takes time to learn the language of the subjects.

Secondly, the background in which the subjects produce or speak the language needs to be appreciated. This is done through reading the pre Parliamentary and Parliamentary materials and case law whereby some background understanding could be obtained. Thirdly, the relationships that exist between the subjects are considered and documented in Chapters 7 and 8.

9.3.1.5.1 SEMIOTICS

A reader brings meaning to and creates the text that is read. This means that there is no absolute point or degree zero in a text (Barthes, 1973). Three issues are involved in this assertion.

Firstly, texts are not unambiguous in their meanings. Readers bring to them their own experiences with the experiences that are written about. Secondly, they bring their own understandings and interpretations of the words that are used in the text. Thirdly, as they emotionally and cognitively interact with a text, they may be drawn to it, repulsed by it, disagree with it, not understand it or completely accept it. They do not have a neutral relationship to the text that they read. Readers constitute the text as they read it and interact with it.

The semiotic framework in the bracketing stage (embracing unitising, taxonomy, defining) would simply have made these definitional interpretations more explicit. It would have explicitly organised the reading in terms of codes, oppositions, unfolding meaning, metaphors and metonymies. It is an attempt to reduce intrinsic (textual) ambiguity and extrinsic (researcher) ambiguity. It is a common feature for interpretive researchers to move straight from the text into sociological interpretations. The definitional meaning of the text is assumed to be unproblematic or possibly unquestioned. It is argued here that if the definitional meanings are 'misinterpreted' due to faulty or incorrect understandings, then the sociological meanings could be likewise too. Such a prior deciphering mode is critical since one acts on the basis of prior definitional meanings yielded.

EISI allows for regressions as well as progressions, for processes of learning as well as unlearning, and in which the intersubjective being of definitional meanings is explored and possibly not reduced to one or other final determining instance, but nevertheless becomes constitutive in explaining and understanding a social phenomena.

The semiotics element in EISI legitimises the development from 'definitional interpretations' into forms of 'sociological interpretations' of social consciousness whilst prevailing research methods focussed on the 'objectivist root' of their texts. They neglected the important semiotic mechanism which could make their definitional interpretations accepted and understood by the actors themselves. For this process of epistemological recognition is an essential prerequisite for the emancipatory success of the subsequent sociological insights. Here EISI develops a reconstructed historical materialism in which the subjective, interpreted social reality, which is reproduced by the textual phenomena is taken into account.

It could be noted that both Harman (1986) and MacCannell (1986) commented that the application of semiotics has remained outside much symbolic interactionist discourse.

9.3.1.6 INTERACTIONISM

The dialectic thrust of EISI is deliberate because interactionism best fits the empirical nature of the social world. There is the playfulness of the mind back and forth with the text, the language, the social actors as well as a fierce drive to make sense of the world which makes one cling to vague images and notions. For they are the researcher's and he must work them out. It is in such forms that original ideas, if any almost always first appear.

According to Blumer (1969), meaning involves interaction between (1) a person, (2) an object, event or process and (3) the action taken towards that object, event or process.

Two factors separate this model from other social psychological laboratory models of interaction. The first is its focus on the 'how' and not the causal 'why' question due to its anti-positivistic standpoint. The second is its commitment to always study two or more data, as dyads and triads and how they interact with each other.

The ability to comprehend a problem as a totality or reducible whole, or relative to other criteria, of being able to take into account a significant number of factors and their relationships is a requirement in the EISI model.

9.3.1.6.1 LIFE EXPERIENCES

Because interpretation is a temporal process, researchers under the framing stage of EISI are advised to study those areas of social life where they have some intimate familiarity. By doing so, they can draw upon the stock of knowledge that has been built up out of previous life experiences. This point is reinforced further when the framing stage forces the researcher to clearly specify the phenomena and research question(s) under investigation. The seeds of interpretation then, are continued within these previous and ideographic experiences.

Unlike the positivists who separate themselves from the worlds they study, the EISI researcher 'participates' in the social world so as to understand and express more effectively its emergent properties and features. Life experiences then give greater substance and depth to the problem the researcher wishes to study. EISI then leads the researcher to seek out topics which echo the types of experiential concern that has puzzled the researcher.

9.3.2 LIMITATIONS

9.3.2.1 NON-REALIST

EISI is built on the ontology that it is nominalist, that the 'reality' to be investigated is the product of individual cognition or consciousness, the product of one's mind. The nominalist does not admit to there being any 'real' structure to the world, for individual cognition is made up of nothing more than names, concepts and labels which are used to structure social reality. It rejects realism.

Realism, on the other hand, postulates that the social world external to individual cognition is a real world made up of hard, tangible and relatively immutable structures. Whether or not we label and perceive these structures, realists maintain they still exist as empirical entities. For we may not even be aware of the existence of certain crucial structures and therefore no 'names' or concepts to articulate them. That does not mean it does not exist. For the realist, the social world exists independently of an individual's appreciation of it. EISI does not encompass this ontological existence, prior to the consciousness of an individual. The realist will argue that the social world has

an existence which is as hard and concrete as the natural world. The EISI model is not applicable to a realist.

9.3.2.2 NON-POSITIVISTIC

The epistemological grounds of knowledge in EISI, especially at the interpretive level of H₃, in terms of how one can sort out what is to be regarded as 'true' or 'false', is anti-positivistic. This means 'knowledge' is of a softer, more subjective kind which has to be personally experienced. It is firmly set against the utility of a search for universal laws or underlying regularities and hence enable futuristic prediction. EISI could not be used to establish definitively cause and effect relationships and henceforth predict mechanically.

Under the positivist paradigm, quantitative, applied and evaluative knowledge are assumed to be objectively valid. Once obtained, such knowledge is then assumed to have a real force and relevance in the applied social world. Under the interpretive EISI paradigm, knowledge can be assumed neither to be purely objective nor to be valid in any objective sense. Rather, the model reflects intersubjective interpretive structures, emotionality and power relations that permeate the situations being investigated. It seeks explanation within the realm of individual consciousness and subjectivity within the frame of reference of the participant. Moreover, an anatomy of power and feeling in the interpretive study reveals that detailed, unemotional, purely cognitive interpretation is impossible.

A positivistic model seeks to explain and predict what happens in the social world by searching for regularities and causal relationships between its consistent elements. Both 'verificationists' and falsificationists' believe that the growth of knowledge is essentially a cumulative process in which new insights are added to the existing stock of knowledge and false hypotheses eliminated. EISI does not cater for the hypothesis testing type of research. It seeks to generate theory rather than test a theory.

9.3.2.3 NON-DETERMINISTIC

The EISI model sees the relationship between human beings and their environment in a more voluntaristic, creative role where man is regarded as the creator of his or her environment.

It rejects determinism which entails a view of human beings responding in a mechanistic or even deterministic fashion to the situations encountered in their external world. Determinists view human beings and their experiences as products of the environment; on which humans are passively conditioned by their external circumstances. The EISI model would not be meaningful to the determinists.

9.3.2.4 NON-NOMOTHETIC

The methodological stand of EISI is ideographic; that we can only understand the social world by obtaining first hand knowledge of the subject matter under investigation. It thus places considerable stress on the researcher upon getting close to one's subject and exploring its detailed background and history. It is thus highly qualitative.

On the other hand, the nomothetic approach to social science lays emphasis on the importance of basing research upon systematic protocol and technique, which focus upon the construction of the use of quantitative techniques for the analysis of data. EISI could not be used to design surveys, questionnaires or personality tests which are components of quantitative research.

9.4 EMPIRICAL

9.4.1 CONTRIBUTIONS

9.4.1.1 WHOLE STATUTORY AUDIT HISTORY

This study has looked generally at all the Companies Acts for registered companies since 1844 and specifically those stipulating the statutory audit. It represents the whole of the statutory audit history for registered companies in the UK to the present day. The extensive time horizon covering nearly 150 years is a landmark in itself. The researcher is not aware of any research covering such a wide reaching archival ground in terms of breadth and depth of study.

9.4.1.2 ARCHIVAL RELIABILITY AND OBJECTIVITY

Because of its historical dimension, it used archival materials (eg pre-Parliamentary, Parliamentary, statutes) which provide the richest context in which any research can take place (Buckley et al, 1976). Once an event is on record it can be carefully studied; more carefully in fact than anyone in the verbal community could ever have done so, for the record remains stable. One can return to it whenever necessary. Most of this research was conducted on primary archives consisting of original documents and official files and records. The research advantage lies in the ability to access and utilise a vast quantity of hard and very often factual information.

A strength in using archival (as opposed to interviews or questionnaire data) is its reliability and objectivity. This refers to the extent to which investigations are repeatable: that if the same procedures of data-collection or capture were used, and the same rules for establishing the veracity are used by different researchers or by the same researcher in a different occasion, the H₁ results obtained here should be reproducible.

But the researcher cannot begin with a study of the message contained in the records. The first task is to understand it properly. Most research conducted on literature written on the statutory audit (see chapter 3) tend to jump this step and assume it to be unproblematic. It requires a study and analysis of the definitional meanings first before offering the interpretive sociological meanings.

9.4.1.3 DEFINITIONAL INTERPRETATIONS

Though both statutory theory and statutory practice are, and have always been, heavily dependent upon the tools of rhetorical and linguistic analysis, no coherent or systematic account of the definitional ambiguity of the statutory audit to language has ever been achieved in the context of the auditor and fraud detection. Even worse, the odd exercises that modern jurisprudence has conducted in the direction of normative linguistics, in studying the 'grammar' of law, or the philosophy of ordinary language in outlining the semantics of rule application, have been exercises aimed at asserting or defending the positivistic view that law is an internally defined 'system' of notional meanings or legal values; that it is a technical language and is by and large, unproblematically, univocal in its application.

9.4.1.3.1 FOUR CANONS

The historical task of systematically relating linguistics to legal theory and conceptions of language use to legal practice through the four canons (literal, contextual, purposive and judicial in s6.2.1) has only been briefly introduced. It seeks to point out that legal language is not by and large, unproblematic and univocal in its application. It must be stressed that the context of this lexical and semantic appropriation was prompted by the general problem of vagueness and indeterminacy of interpreting the statutory audit towards fraud detection in the Companies Act and of the words used.

The study of language or by law in terms of the notional codes or underlying rules that govern the grammaticality or the legality of an utterance, is of undoubted interest in that it can scientifically describe the minimum normative requirement whereby linguistic or legal communication - as intelligibility, signification or syntax - is possible. It was seen that if fraud detection was to become a statutory requirement beyond doubt, then the words 'fraud detection' must appear expressly in the statute books.

Intelligibility, of course, is not meaning; it is merely the normative context within which meanings are realised. Semiotics, in other words, is not semantics; it does not and cannot study meaning as actually realised or manifested in text or utterance as historical or local events. Semantics studies the internal coherence of the object utterance, or the immanent logic of the text and adds to an essentially descriptive concept of the utterance of the text; the categories of a preferred meta language. And thus, the contribution here has been to be concerned with the subjective, historical, social or diachronic dimension or categories of meaning by implicating four possible canons of statutory interpretation.

9.4.1.3.2 APPLICATION TO THE STATUTORY AUDIT

In many respects one of the principal features distinguishing the legal institution from other institutions, and its disciplinary methodology from those of other disciplines, is precisely its language. To learn the law involves learning an archaic and specialised vocabulary and syntax, concentrating upon the derivation and etymology of a legal dictionary of meanings, together with elaborate rules and procedures of reference, delimitation and construction.

In pursuance of this, the object of the study moves from system to practice, from definitional meanings to the determination and realisation of meanings within the concrete and hierarchical organisational forms of social interaction. The object of study becomes the 'actually existent' language system in its historical and social development, the study of the 'internal stratification' of the statutory language according to social dialects, professional jargons, languages of the Parliament, languages that serve the specific socio-political purposes of the day.

As can be seen in Figure 6'3, a hierarchy of codes was further set up consisting of a system of classes (source of auditor's duty vs role) to fit the subject matter so that a 'level' for fraud detection can be assigned and relationships among the classes can be described. In fact for each statutory provision analysed, the devised coding system was extremely useful in putting forth a 'tangible' label [eg 1b(v), 4a] under each of the four canons of construction. In fact, the taxonomy system in Figure 6'3 could be used on a more wider application level towards the common law duty, profession duty or contractual duty.

The development here of the sociolinguistics of legal language under the four canons has an important role to play in evidencing the linguistic mechanisms and the conflictual social reality of the production of definitional meanings and the construction and manipulation of consensus which forms the object of positivistic rhetorics.

9.4.1.3.3 SALIENT POINTS

The objectives developed (s2.6) are based upon a genuine topical auditing issue - namely fraud detection and thus the analysis of the data focuses upon the knowledge that is demanded in any statutory reading.

It is against this background that one believes it is valuable to reassert the rhetorical, sociolinguistic and loosely pragmatic dimensions and contexts of any communicational practice. It is in many senses the defining paradox of contemporary legal culture that its ideology is one of consensus and of clarity - we are all commanded to know the law - and yet legal practice and legal language are structured so as to prevent the acquisition of such knowledge by any other than highly trained specialists in the various domains of legal study. When the numerous and diverse coded statutory H₂ mini

interpretations were summarised in Figure 7.2, it was such an eye opener in providing 'tangible' evidence of the indeterminacy and lack of clarity in a statutory provision. It is a contribution to the complexities of understanding the statutory audit. An attempt has been made here to develop a more inclusive account of what definitional interpretation is.

To understand the paradox of the social discourse of the law requires an interdisciplinary approach to legal texts as well as to the informal practices of the legal institutions, and will include the study of the rhetoric of law, the analysis of the context and pragmatics of legal speaker and legal institution, the empirical examination of the functions and affinities of law viewed as communication and function. It should be emphasised again that the study demonstrated the analysis of the politics of legal language in terms of social and intertextual character of legal communication.

Lastly but not least, a point to reiterate is that there may be more than one expectation gap. An area that has possibly been missed out is the 'interpretation gap' as a component of the 'expectation gap', due to the diverse possible definitional interpretations emerging from the statutory provisions.

9.4.1.4 SOCIOLOGICAL INTERPRETATIONS

The nascent study of the conjunction of statute law and language should not simply be one of style and presentation only. Both conventional jurisprudence and traditional linguistics have viewed their objects of study as being the 'rules' or 'codes' that govern, respectively law application and language usage and thereby largely ignoring the sociological dimensions. The past historical surveys or analysis covered in the literature search show that sociological accounts of legal language are historically and geographically limited. There seems to be an oblivion to the historical and social features of the formation of statute law for the auditor.

More significantly perhaps in relation to ideology, the law fixes legal meaning to individual acts, conceived in the Courts by the abstract terms of the 'purpose or intention of Parliament', and in so doing it constantly evades the question of its own material and historical genesis or basis and effects. The problematic notion of 'purpose' or 'intention' was exposed in s7.5.4.2. The phrase is regularly used by the

judges in statutory interpretation although it is meaningless unless it is recognised for what it is.

It is argued that legal language, like any other language usage, is a social practice and that its enactments will bear the sociological imprints of such practice. In view of this, legal discourse is inevitably deeply rooted within the political, social and economic commitments of its times. An attempt has been made in this study towards understanding and offering some sociological interpretations in these areas.

9.4.1.4.1 SALIENT POINTS

Due to the unique epiphanic thrust in the EISI model, an explanation section (s7.5.3) was created in the micro purposive section for the epiphanies since it is the purpose that generates the sociological epiphanies. The most obvious feature of statute law and legal discourse here is its production within specific highly restricted institutional settings. The focus on the Companies Acts incorporating change on the levels represent a contribution to a deeper understanding of how the shifts in the level of auditor responsibility towards fraud detection under statute came about. The epiphanies provided a niche battleground in which reformers and obstructionists fought so bitterly, which further expanded one's insight into the larger historical, institutional and cultural arenas. The researcher is not aware of such specific and rigorous epiphanic studies conducted in any previous research in this area.

As law establishes the framework for society and attempts to ease the tensions within it, Parliament's legislative proceedings offered many insights into the society of the day. Above all, legislation reflected the country's changing needs, whether major, as with the European Communities Act 1972, or a matter of a specific urgent problem, as in the case of some swiftly enacted panic legislation on the statutory audit in the aftermath of a national banking disaster. An Act may be introduced to tidy up administration, for purely political reasons or to meet a moral dilemma.

Whatever the reasons, the relationship between statute law and social change is not a single nor a simple one. Nevertheless an attempt has been made in this study to highlight some of the possible factors which may have led to the statutory changes affecting the auditor's duties as documented in s7.5.4.1.

9.4.2 LIMITATIONS

9.4.2.1 SELECTIVE DEPOSITING

The research is heavily reliant on archival documents and records. The researcher is interested in tracing regularities or irregularities in social relationships and social action. Data from the earlier times are therefore particularly valuable in providing information about the extent to which patterns of social relationships persist as contrasted with the extent to which they change. It affects the interpretations emerging.

But few chroniclers of the past have been interested in recording observations of social relationships and social actions according to the researcher's interests. All producers of messages have aims in communicating them, but their aim is not necessary to communicate social historical knowledge to us. Hence information which is vital to the researchers is often missing or disjointed presumably because the chroniclers of those times did not think these points were significant.

One needs to go further than the daily newspapers or the typical corporate report to justify the contention of selective depositing. Hansard in the earlier part of the 19th century was not reported verbatim. The biases extend toward certain moralities, events of historical significance, political or economic systems and to an endless list of other issues. In fact, these biases are so prevalent as to create the need for a revisionist whose total preoccupation is to 'rewrite' history in an effort to emphasise a different set of things. One lacks access to the rationale of those who failed to communicate. Moreover, reports or minutes of meetings go unpublished or the editor applies his/her blue pencil and scissors to it.

For Foucault, the archive is not just an inert depository of past statements preserved for future use. It is the very system which makes the emergence of meanings possible. The archive of a period, let alone a society, cannot be described exhaustively. The survival of archives is constantly subjected to reactivation, loss or even destruction.

9.4.2.2 PRIOR UNDERSTANDINGS

It was acknowledged that a strength of the EISI model was the recognition that the researcher should be using his or her life experiences as the basis for the topic of study. But it can work the other way too.

There is the problem of incorporating prior understandings into the interpretations emerging from the research. Prior understandings would include background information and knowledge on the subject, concepts, hypothesis and propositions contained in the research literature, and previously acquired information about the subject and his experiences. Nothing can be excluded, including how one judged the phenomenon at the outset of an investigation. This is the case because prior understandings shape what is seen, heard, written about and interpreted. To exclude them is to risk biasing the interpretations in the direction of false objectivity.

The researcher, like the subject is always in a hermeneutic circle, always seeing situations and structures in terms of prior understandings. Full objectivity, all encompassing knowledge of a subject or situation is never possible.

9.4.2.3 RESTRICTED HORIZONTAL EMPIRICS

When a researcher sets about systematically gathering information about a problem that he wishes to find an answer to, he is faced with certain conflicting demands on his time. On the one hand he needs, ideally, to extend his inquiries over a large number of instances in order to take account of the full range of variation in the phenomenon he is interested in. The subject matter keeps on participating in larger systems. On the other hand, he needs to become sufficiently well acquainted with each particular instance to enable him to obtain enough understanding about it in order to be able to make trustworthy judgements. Clearly, the more he satisfies the one need, the more he frustrates the other.

The techniques of information-gathering available to the researcher therefore may be ranged along the two contrary dimensions of 'numbers involved' and 'personal involvement'. No matter which way one turns, the study will lack something - in comprehensiveness or completeness or both. Clearly those working within a 'positivist' orientation will tend to work towards the 'large numbers/low personal involvement' end

of the continuum, whereas those working with an 'interpretive' orientation will tend to work towards the other end.

This means that it was necessary to focus only on company law in particular since the time span investigated covered nearly 150 years of that statute's history. What is lacking here is the further empirical insights that could be gained from non-statutory case law data and professional pronouncements since all these three influencing factors impinge on the practical role of the statutory audit. In actual practice when this happens, the position is a good deal more subtle and difficult to disentangle. Hence for this study, given the constraints of time, labour and cost, the practical line of inquiry was a restriction to analysing material collected on the company law alone.

9.4.2.4 COMPANY LAW AS SURROGATE

The reflections on statute law have been based predominantly on insights from company law. For it is within company law that the statutory audit provision resides. So strictly speaking, the statutory interpretations have been narrowly deduced from the basis of the statutory audit provisions.

It is argued that such a process of inductive logic may not be a sufficient basis to guarantee the conclusions. It is a major qualification of this study.

9.4.2.5 NON-VISUAL DATA

It is so banal to state that one must first establish the meaning of a message before one uses it. First the historical researcher works with a text, not a performance. He has in fact a mutilated message before his eyes. Much of the redundancy of the message was expressed in tone of voice and body language, which is usually not recorded and is lost. Much of the visual impact of the audience is lost. So historical researchers work with impoverished data in many cases.

9.4.2.6 EXPLICIT vs IMPLICIT MEANINGS

In the bracketing stage, there was the problem of apparent (explicit) and intended (implicit) meanings. Suppose that the researcher knows the language well and has no difficulty in understanding the apparent meanings. He cannot assume that the intended

meanings can be as easily deciphered. Subjective judgements do come in by reference to any inferred words used. Circumlocutions and word taboos occur, resonances are not perceived, parallels that leap to the minds of those reared in that period are missed or not captured by the contemporary researcher. All sorts of cultural clues as to the meaning of the message, especially with the more difficult implicit meanings can remain unperceived. Moreover to confuse things even further, in most cultures intended and apparent meanings are not always present or the same (Vansina, 1985). This leads us to the next problem of culture.

9.2.4.7 CULTURAL DISTANCE

It was established earlier that a contemporary researcher must study the language of the text before s/he even begins to gather traditions and offer interpretations. Even if s/he does attempt to perform a thorough linguistic training and makes an attempt to learn the language, s/he still cannot be expected to have mastered its intricacies to the point say, of noticing choices of expression in the most accurate way possible of that translation of culture. Whoever uses texts in translation over culture or time must be aware of such problems, just as they must be aware of translation problems in general. The exact meaning of words used in a text is never a simple matter when dealing with unfamiliar historical cultures. The meaning of any word only becomes intelligible when the actual context in which it has been uttered is taken into account. For most words this poses no difficulty. But some words (eg true and correct) are key words; they cannot be understood fully unless one is thoroughly acquainted with the society and culture from which they stem. To complicate things, key words include complex technical terms relating to any sphere of social and cultural life.

The problem with these key terms in any text is their powerful resonance in the minds of the speakers or legislators and their audience. Every reiteration recalls a portion of the semantic field to which they apply and gives a particular hermeneutic colouration to them. It takes a true knowledge of a whole culture or society to be able to find or rather feel exactly what the meaning will be in such and such a case.

In the coding stage of bracketing, the researcher has attempted to combine the identified indicators or messages into a single index of the characteristic level of fraud detection. Having done this, however, how can he be sure that his 'levels' reflect the characteristic of comprehension by the different historical cultures? All the researcher

has done is to explicate how he arrived at those levels step by step on the basis of the plausibility of the arguments used in justifying his choice of particular indicators.

To arrive at the intended (implicit) meaning, it is necessary to cope with problems of metaphor, stereotypes and complex stereotypes or cliches. One is referring here to the sub-quality of understanding the meaning of a message in the same way that others in the culture of that period understood it, or as closely as is possible to come to that ideal.

9.4.2.8 SMALL SAMPLE SIZE

When the issue of interpretation of the statutory audit is brought before the Courts, it is a valuable indicator of wider social oppositions and tensions in the practical application by the communities. A systematic study might equally throw light upon the social conflicts within it. But records of such comprehensibility of the statutory audit towards fraud detection were limited to those that were brought to Court and these were only a very small proportion (7 cases in nearly 150 years of statutory audit history) of the complaints made in statutory interpretation. There exists more on case law which has developed without statutory reference to the Companies Acts where the auditor is taken to Court for failing to detect fraud.

The researcher's problem is further exasperated where records of higher Court cases do exist (lower Courts tend not to report their cases), they frequently lack the detailed information which would enable us to see the wider framework of social relationships and statutory understanding within which the auditor (the accused) and the client (the accuser) operated.

As with official statistics, a researcher using historical records has to accept the fact that the records have been created for purposes other than for sociological analysis. If he wishes to use these material for his own analysis, he must try to assess these purposes and make allowances for them in order to make his own subjective interpretations of the material.

9.4.2.9 RETRIEVAL/EDITORIAL BIAS

Likewise the retrieval of information is subject to systematic bias and sampling errors. It has been said the preacher chooses his favourite passages from the scriptures, thus the researcher can also seize upon certain evidence and ignore others.

To these deficiencies can be added the problem of editorialising or filling in the gaps. This happens whenever the researcher adds his own suppositions in an attempt to 'complete the record'. Just as from a few scattered bones, the archeologist reconstructs ancient men, so too the researcher glues together evidence from a variety of sources with the framework of his own thoughts and language. The evidence which is referred to, in many instances may reflect the unconscious or conscious personal prejudices of the researcher. For after all, the study of social phenomenon is usually interconnected and affected by many determining factors, some of which may not be immediately appreciated by the researcher.

The observations of the researcher are guided by various abstract concepts which the researcher himself unconsciously brings into his observations. Unfortunately, this is a counsel of perfection which is not or cannot always be followed due to unconscious bias creeping in.

9.4.2.10 INHERENT LIMITATIONS

A fundamental deficiency relates to the inherent limitation imposed by the need to observe and imagine. It requires personal, physical involvement over extended time periods. Only a relative small number of situations can be studied in this detail, and then is limited by the ability to generalise from these isolated instances. There is also the problem of staticism which is an attempt to conceptualise a dynamic problem issue in static terms so as to make it more observable.

9.4.2.11 'PURE' VALIDITY

The problem of 'pure' validity with the interpretations is difficult to ensure. Validity refers to the extent to which the researcher's interpretation of the underlying

characteristics s/he wishes to reflect is in fact a faithful representation of that characteristic.

The problem of validity is equally difficult for those working within an interpretive framework, for they must be sure that the meanings they attribute to people's statements, actions or gestures are the same as those that the people themselves attribute to them. This is in fact extraordinarily difficult to establish, simply because people are not accustomed to putting their perceptions and feelings about meanings into words and may offer stereotype responses to direct questions rather than accurate accounts of those meanings.

The sociological interpretive researcher must often rely on his sensitive appreciation - almost his intuitive understanding - of the unstated assumptions lying behind people's actions and behaviour. The researcher in the end, is driven to establishing his own sociological assessment of the meaning and this subjective and possibly speculative assessment carries with it as many difficulties about validity as the variables constructed by the positivists.

9.2.4.12 PROVISIONAL CONCLUSIONS

The interpretations and understanding emerging will always be unfinished, provisional and incomplete. This is due to a wide variety of possible factors, one of which is the unavoidable intellectual bias. Because understanding and interpretation are temporal processes, what is regarded as important at one point may at a later time be judged not to be central.

The other is that due to the labyrinths and the multiplexities of ascertaining 'truth', one has to reject totalisation at the ontological or analytical level. The field of analysis must remain open and unbounded. The researcher can only propose the analysis of specific features of the social field, perhaps drawing some subjective connections between those features on other levels but no more than that. The totality remains a horizon of thought, never its object.

They start anew when the researcher returns to the phenomena. This means that interpretation is always conducted from within the hermeneutic circle. As one comes back to an event or experience and interprets it, prior interpretations and

understandings shape what is now seen and interpreted. This does not mean that interpretation is inconclusive for conclusions are always drawn. It only means that interpretation is never finished. To think otherwise is to foreclose one's interpretation before one begins. The interpretive researcher should not start a research project thinking that s/he will exhaust all that can be known about a phenomenon when s/he ends the project.

9.5 IMPLICATIONS FOR FUTURE RESEARCH

Below are some suggestions for future research projects which have been developed as a result of embarking on this research and the realisation of its limitations.

- 1** In the area of the auditor and fraud, this research has only focussed on fraud detection. The issues on fraud that the auditor is also required to address over time, but perhaps more so over the last twenty years or so is that of fraud prevention and reporting. Each of them merits a study on its own which could be repeated out on the EISI model. And the interactions between detection, prevention and reporting also pose another possible project.

- 2** The Companies Acts were the realm chosen to study the auditor's role towards fraud detection because it represents statute law as the highest authoritative level of responsibility that can ever be imposed on the auditor. The subsequent important levels of responsibility affecting the auditor are in the areas of common case law and professional pronouncements in terms of auditing statements (U series), auditing guidelines and ethical guidance statements. There is a lot of material available in both common law and professional pronouncements and could be carried out as two separate projects. How each of these influencing factors over time extend or restrict the fraud detection role when they are put side by side would also merit a separate project.

- 3** Whilst this study has concentrated on registered companies, it has ignored the level of responsibility under the Financial Services Act 1986 which is specifically for investment businesses only. As both the Financial Services Act and the Companies Act come under the umbrella of statute law, it would be interesting to see how that duty varies between registered companies and investment businesses.

- 4** The geographical boundary for this research was set within UK history. Studies could also be carried out in other countries to obtain an understanding of how their fraud detection duty has evolved for the audit by comparing and contrasting the problems and similarities. Of course, the cultural and structural differences must be taken into consideration. The international study could perhaps focus on the EEC countries because of its impending harmonisation of all its member countries' laws.
- 5** So far, the term fraud is used as if everyone knows exactly what it means. A brief study was carried out in chapter 1. The tabulation of the findings in Figure 1.5 represents a contribution towards an understanding of the meaning of fraud. It concluded that the lack of a clear definition of what actually constitutes fraud is one of the reasons why both the law and professional bodies experience such difficulty in providing guidance on responsibility for its detection and in dealing with it if detected. It is a worthwhile challenge to embark on explicating this problematic term (nationally, internationally, over time, between social groups) to assist the law and professional bodies towards an agreed definition.
- 6** It is believed that the doubts and uncertainties manifested in the statutory interpretation of the audit has been a silent contribution to the expectation gap. This could have been due to the cognitive mode of perception carried out through an explicit reference by the auditors and an implicit reference by the public. Further work needs to be carried out to either collaborate or refute this 'interpretation gap' within the expectation gap.

It is argued that the singular attachment to the expectation gap needs to be queried, as if it is simply a problem between the auditor and the public. It is suspected that there may be an expectation gap between the auditors themselves and also one for the public, within and without the social groups. The gap may not be singular but a multi-faceted pluralistic one. Hence research is required in this area.

7 Finally, but not least, the ideas developed for this study require a sequel. It stopped with the 1989 Companies Acts but should be extended into future Companies Acts.

A more systematic study should be carried out to see if there are further possible canons of statutory interpretation besides the four highlighted here. The mode of interpretation carried out by the judges still remains very much a mystery.

The interpretations and meanings evolved here need to be further re-examined, rediscovered and reinterpreted for the researcher who returns to this research scene in the future, with the added tools and data-bank of knowledge. This piece of research is still seen to be very much in its embryonic stage and should be used as a stepping stone, to be subjected to repeated future revision and improvements towards one's insatiable quest for knowledge, truth and reality.

9.6 SUMMARY

The EISI method consists of six steps, starting from framing, contextualisation, capture, bracketing, construction and consolidation. They are applied as follows.

In the framing stage, the three research questions framed are as follows:

- a) When and where did the auditor's duties emerge?
- b) What was the extent of those duties in relation to fraud detection?
- c) How did those duties come about?

As all understanding is contextual, this research has sought to concentrate on the context of statute law (in particular Company Law) on the auditor's duty towards fraud detection from the viewpoint of the researcher as an auditor. This stage further refines the framed questions into:

- A) When and where did the auditor's statutory duties emerge under the Companies Acts 1844-1989?

B) What was the extent of those statutory duties in relation to fraud detection?

C) How did those statutory duties come about?

Once the contextualised questions have been established, the capture stage begins by gathering the data. In doing so, one is scanning for data through all the relevant Companies Acts since 1844 on the auditor's duties which addresses the (A) question above. The captured data is presented in s5.2.

With the captured data, a more detailed analysis is carried out on it in bracketing which involves two main steps, to address the (B) question. Firstly, the key words or brackets in the relevant Companies Act provisions are singled out (as highlighted in bold print in the wording of sections in s5.2.1-5.2.15). Secondly, the definitional interpretations of these bracketed words are carried out, using the literal rule, contextual rule, purposive rule and judicial rule. The source documents for these definitional interpretations are the Companies Acts, Parliamentary materials and case law. Consistency of definitional interpretation is maintained when looking at the various sources by adopting a plain or ordinary meaning to the language used. This would be a common and normal frame of reference for most readers.

Construction then builds on bracketing. It reassembles or constructs the defined brackets in a graphic form for each of the Companies Acts in a chronological manner under each of the rules. An attempt at the 'how' question in (C) is made here by seeking to provide some explanations for the purposive graph since it is the purpose that generates the sociological transformations. Also, the 'rules' have generated various graphs and an attempt was also made to obtain some understanding to these various mechanisms of statutory construction of the statutory audit in the Companies Acts.

The final stage of consolidation seeks to bring together the four constructed graphs. It seeks to provide some further insight to the consolidated graph and their interrelationships towards the understanding of the interpretation of the statutory audit.

The following is a summary of the main findings from this study.

This study has examined all the relevant Companies Acts for registered companies since 1844 in trying to ascertain the role of the auditor with respect to fraud detection. If one were to study the Companies Acts literally, the auditor has no explicit duty but only an implied duty which appears to have moved from fraud in the books to material fraud. Contextually, the conclusions were similar, but post 1981, due to the contextual insight of true and fair being compliance with the minimum disclosure requirements, it seems that fraud detection would need to be arranged under a specific contract. On the purposive level, it seems to fluctuate moderately on the statutory level, including entering the explicit level, thereby confirming that there is some duty to detect fraud. One would argue that this would be a more exacting duty as the purposive duty was supported by evidence from Parliamentary materials, the source of all legislation. Auditors of banking companies also tend to receive a greater duty for fraud detection as seen in 1844 and 1879, probably due to the wider social effects and misery of banking frauds, lately evidenced by BCCI. Based on the limited sample of case law, it seems that up to 1967, judges tend not to state for the auditor an explicit duty on the auditor to detect fraud. But since the *Thomas Gerrard (1967)* case, it seems that the Courts have imposed a duty to detect fraud, within reasonable care and skill.

The findings as summarised in Figure 7.2 show that whilst fraud detection has not been legislated as an expressed provision under the Companies Acts, meaning that there is no absolute duty to detect fraud, there may be an implied duty to undertake some responsibility under the Companies Acts. It shows that Company Law has not been as 'silent' in establishing a duty on the auditor to detect fraud as generally believed. Hence, a total blanket disclaimer of such a duty from the auditor would be too presumptuous.

The numerous and diverse definitional interpretations were such an eye opener towards the indeterminacy and lack of clarity in the statutory provisions. Using the four rules, it reveals an account of the definitional ambiguity of the statutory audit to the statutory language used in the context of fraud detection. It shows that the understanding of the auditor's statutory duties, is a multi-faceted one. It exposes the defining paradox of legal culture that its ideology is one of consensus and of clarity; that by and large is unproblematically univocal in its understanding and application and hence, we all can and are expected to know the law precisely. The question of sociology and legal theory 'how is regulation possible?' needs to be reformulated to 'how is comprehensibility possible?'.

It shows on a more inclusive account that the auditor's statutory duties can mean different things to different people depending on which rule or frame of reference one adopts, be it literal, contextual, purposive or judicial. The study of law in terms of the notional rules that govern the interpretation of a legal text then becomes important for the auditor.

In the literal rule, it was seen that though primacy needs to be given to the statutory words used, it can be reduced to utter nonsense by a strict literal and wholly unimaginative construction. Whereas in the contextual rule, it was noted that a contextual understanding of the other statutory provisions can either modify or reinforce the literal understanding reached. The purposive rule has helped to make the 'indeterminate' statutory provisions a bit more explicit and clearer by tracing it back to the intention of Parliament and the mischief it sought to remedy. And lastly though the judicial rule casts a long shadow over the interpretation of statutes generally, it was noted that the purposive rule was not adopted by the Courts who were in favour of the literal rule. However, with the gradual harmonisation of the European Community Law into the English Law, it is envisaged that the UK Courts will have to adopt the purposive rule.

It also discovered that the Companies Acts in defining or changing the auditor's role are a product of the political, social, economic and administrative circumstances and of reactions to those circumstances in terms of which they are regarded as raising issues or constituting problems requiring action; the perspectives of the Government, having shared functional representation from the affected groups, which may be ignored by the Government; the invisible function of the draftsmen to give legal effect to the policies; the problems with language and other practical constraints such as Parliamentary time. It was seen that statutory language, like any other language usage, is a social practice and that its provisions will bear the sociological imprints of such practice or institutional background and further that as a discourse or genre, statutory discourse is inevitably answerable to or responsible for its place and role within the political, social and economic commitments of its times.

The study concluded that if fraud detection was to become a statutory duty beyond doubt, then the words 'fraud detection' must appear expressly in the Companies Acts or other statute books. Otherwise the 'interpretation gap' as a component of the

expectation gap will continue to persist due to the possible diverse definitional interpretations emerging from the statutory provisions.

9.7 ENVOI

In conclusion, new ideas, as Weber (1958) in the preamble suggests, do not come at specific times during the day. Unfortunately, the researcher must be prepared for non-productive periods; research time will be interrupted or be set aside. The best that can be hoped for is the creation of conditions conducive to work and insight.

Once this view of the creative process is accepted, a major problem confronting any researcher is the stimulation of a psychological state in which new ideas can appear. In this sense, no researcher can ever separate his/her personal and public lives. S/he is continually thinking, puzzling over and troubled by unsolved issues. As Weber (1958) states:

"In the field of science, only he who is devoted solely to the work at hand has personality."

The researcher, like all human beings, is forever conversing with himself, checking out plans of action, experimenting with new formulations, combining contradictory events and judging future action against what has succeeded and failed in the past. It is in the arena of private conversations with the self that new ideas appear, that the exegesis and expositions take place and that insights, meanings and interpretations are constructed. For after all, the inquiring mind must always push beyond that which is known or formalised.

EISI is unaccompanied by rigid experimental design or control. It is performed in 'muddy waters', where the variables and parameters are largely undefined and the only anchor is the researcher and his expertise. Beginning with little knowledge of the results, the researcher makes observations within a single setting of the statutory audit under the Companies Acts; and records, summarises, interprets and reports on events relative to his topic of interest. Good research is characterised by careful chronologies, sustained observation and perception into the details (Buckley et al, 1976). This piece of research has been carried out with these criterion in mind.

Only after these ideas are transferred to the written page or communicated verbally to others, does the scientific process shift from the private to the public arena of discourse. This has been the aim of this thesis towards documenting the socialisation of the knowledge gained. It ends with the full acknowledgement that the last words from this thesis are that 'the end is but only the beginning'.

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