

# Future of Audit

Key highlights of the Brydon Report on improving audit quality and effectiveness





A review around audit quality, the third of such reviews commissioned by the UK Government, was recently completed by Sir Donald Brydon. The Brydon Report has made interesting recommendations, which address many issues relevant to the audit sector in India as well. In fact, the Report hopes that the recommendations are applied universally as they address problems across various jurisdictions that include India, the United States, Canada and Australia. These recommendations are a result of a consultative process where views were sought from relevant stakeholders from around the world including India.

## Key recommendations



### A new profession

- The Report recommends that 'audit' must be redefined in terms of its purpose, that is, to 'establish and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report including the financial statements'.
- The Report recommends creating a new profession - 'corporate auditing' - encompassing areas beyond financial statement audit. To address the observation that audit today is swamped with rules, it recommends to establish principles 'to form an overarching framework governing the behaviour of corporate auditors'.
- The report suggests introduction of suspicion as a quality in an auditor. The auditor has been labelled for decades as the watchdog and not a bloodhound. However, the Report recommends that an auditor should possess both qualities of professional scepticism as well as suspicion and should be trained enough to discern the circumstances to which either of these qualities is relevant.
- It further recommends redefining the liability regime to ensure that there are fewer obstacles to a more informative audit, however, doesn't venture further in this space.
- Auditor resignation also finds a place in the Report, with changes being recommended to strengthen the process of informing shareholders and other stakeholders of the reasons behind resignation, dismissal or not participating in a tender. These recommendations are a toned down version of the reforms recently implemented by the Securities and Exchange Board of India (SEBI) for listed companies in India.

#### The Brydon Report on improving audit quality and effectiveness:

<https://www.gov.uk/government/publications/the-quality-and-effectiveness-of-audit-independent-review>



## Scope of audit

- The Report envisages an expanded role for the audit committee, which includes the audit committee publishing a three-year rolling Audit and Assurance Policy that covers the process of appointing auditors, scope of audit, fees, framework for decisions around materiality, etc.
- Fraud reporting and whether detection of fraud is within an auditor's remit have been a much-debated topic across the world. The Report recommends that the auditor should 'endeavour to detect material fraud in all reasonable ways'. A package of measures around fraud detection and prevention has been proposed that includes training auditors in forensic accounting, reporting by the auditor on the adequacy of steps taken by the board around fraud prevention and detection, etc.
- The Report has proposed that auditors should report to both the audit committee and the shareholders on the extent to which their work has been influenced and informed (or not) by any external signals that might imply enhanced risk in the company whose financial statements are being audited. External signals could potentially include extent of short positions, sustained negative commentary, falling credit rating, loss of banking facilities, etc.
- The Report further suggests extension of audit to new areas including Alternative Performance Measures and Key Performance Indicators used for the purpose of calculating executive remuneration.
- Increased use of technology including data analytics to consider 100% of transaction data rather than sampling, blockchain-based data repositories, etc, is also one of the suggestions proposed in the Report.



It is interesting to note a section in the Report dealing with 'culture' of the company being audited. The Report recommends that auditors should make a reference in the report where there is an observed disconnect between the culture of the company claimed by the directors and the behaviour observed by the auditors.



## Communication

- Greater engagement of shareholders with audit and auditors has been encouraged by the Report, by letting them expand the scope of audit by requesting emphasis on any specific area in the audit and also requiring the auditor to answer questions raised by shareholders at the general meeting.
- A change to the language of the opinion given by auditors is being proposed by replacing the currently used phrase 'true and fair' with 'present fairly, in all material respects'. It is also proposed that the audit report should include the hours spent by auditors on the audit, broken down by the level of the auditor as well as a discussion around quality of estimates.
- Apart from the Audit and Assurance Policy, the Report proposes a Resilience Statement (dealing with going concern assessment for short, medium and long term) and a Public Interest Statement that is required to explain the company's view of its obligations to the public interest, whether arising from statutory, self-determined or other obligations, and how the company has acted to meet this public interest over the previous year.
- It also proposes that firms conducting statutory audit of public interest entities (PIEs) should publish financial information including profitability of the audit practice and remuneration policy and annual remuneration of each relevant senior statutory auditor.



## Our view

While these are currently recommendations and whether they get implemented in their current form remains to be seen, the direction is quite clear. The stakeholders expect a lot more from audit and auditors than what exists today. To remain relevant and add value to the economy, the audit profession needs far-reaching changes beginning with a change in the mindset of the auditors.

# Contact us

To know more, please visit [www.grantthornton.in](http://www.grantthornton.in) or contact any of our offices as mentioned below:

## NEW DELHI

National Office  
Outer Circle  
L 41 Connaught Circus  
New Delhi 110001  
T +91 11 4278 7070

## NEW DELHI

6th floor  
Worldmark 2  
Aerocity  
New Delhi 110037  
T +91 11 4952 7400

## AHMEDABAD

7th Floor,  
Heritage Chambers,  
Nr. Azad Society,  
Nehru Nagar,  
Ahmedabad - 380015

## BENGALURU

5th Floor, 65/2, Block A,  
Bagmane Tridib, Bagmane  
Tech Park, C V Raman Nagar,  
Bengaluru - 560093  
T +91 80 4243 0700

## CHANDIGARH

B-406A, 4th Floor  
L&T Elante Office Building  
Industrial Area Phase I  
Chandigarh 160002  
T +91 172 4338 000

## CHENNAI

7th Floor, Prestige Polygon  
471, Anna Salai, Teynampet  
Chennai - 600 018  
T +91 44 4294 0000

## DEHRADUN

Suite no. 2211, 2nd floor Building  
2000, Michigan Avenue,  
Doon Express Business Park  
Subhash Nagar, Dehradun - 248002  
T +91 135 2646 500

## GURGAON

21st Floor, DLF Square  
Jacaranda Marg  
DLF Phase II  
Gurgaon 122002  
T +91 124 462 8000

## HYDERABAD

7th Floor, Block III  
White House  
Kundan Bagh, Begumpet  
Hyderabad 500016  
T +91 40 6630 8200

## KOCHI

6th Floor, Modayil Centre point  
Warriam road junction  
M. G. Road  
Kochi 682016  
T +91 484 406 4541

## KOLKATA

10C Hungerford Street  
5th Floor  
Kolkata 700017  
T +91 33 4050 8000

## MUMBAI

16th Floor, Tower II  
Indiabulls Finance Centre  
SB Marg, Prabhadevi (W)  
Mumbai 400013  
T +91 22 6626 2600

## MUMBAI

Kaledonia, 1st Floor, C Wing  
(Opposite J&J office)  
Sahar Road, Andheri East,  
Mumbai -400 069

## NOIDA

Plot No. 19A, 7th Floor  
Sector - 16A  
Noida 201301  
T +91 120 485 5900

## PUNE

3rd Floor, Unit No 309 to 312  
West Wing, Nyati Unitree  
Nagar Road, Yerwada  
Pune- 411006  
T +91 20 6744 8800

For more information or for any queries, write to us at [contact@in.gt.com](mailto:contact@in.gt.com)



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