

Dialogue with Sir Donald Brydon

Recent controversies in the United Kingdom have brought accounting and auditing into the limelight, prompting calls for greater scrutiny and for deep changes in the way auditing takes place. Reviews of the profession have assessed its market structure and its regulation by the Financial Reporting Council (FRC). In 2019, the UK Secretary of State for Business, Energy and Industrial Strategy commissioned Sir Donald Brydon, the outgoing chair of the London Stock Exchange and an experienced corporate director, to lead a fundamental review of auditing. Sir Donald's December 2019 report argued for a comprehensive reform of auditing and changes in corporate governance and reporting. He offered 64 recommendations on how audits should be conducted and overseen by audit firms, by boards and audit committees, and by regulators. Nearly a year after its release, the report is still being debated as implementation has been slowed by both the global pandemic and Brexit.

On 17 November 2020, Sir Donald joined members of the European Audit Committee Leadership Network (EACLN) to discuss his report, focusing on recommendations of greatest relevance for audit committees and boards. *For a biography of Sir Donald, see Appendix 1, on page 9, and for a list of network members and other participants, see Appendix 2, on page 10.*

Executive summary

The dialogue between Sir Donald and the EACLN members touched on three themes:

- **Background of the review** (page 2)

Sir Donald began the discussion by explaining his overall approach to the review and the objectives of the audit model that he developed. He articulated a vision of an audit that provides information that helps answer three questions: (1) Is the company being honestly run? (2) Does it have a reasonable chance of survival? (3) Is the information the company is providing useful for decision making? His work sought to understand the environment of audit and how all the pieces could come together to achieve this vision. He received 120 responses to his call for input, and he convened over 100 meetings and roundtables with interested parties.

- **The corporate audit** (page 3)

Sir Donald underscored the importance of extending assurance to cover alternative performance measures (APMs) and other information not in the financial statements. These are increasingly important to shareholders and other stakeholders, and *“they should be held to the same standard of quality”* as the measures and information in financial statements. EACLN members strongly agreed that APMs and other information outside the financial statements should be audited, and they also agreed that the lack of uniform standards for auditing this information should not prevent auditors from moving forward.

Several members noted that they had already implemented some level of assurance on APMs at their companies. However, Sir Donald and the members acknowledged that a wider scope for the audit would require both auditors and audit committees to expand their capabilities, which for auditors could mean the establishment of a broader audit profession.

- **Engaging with stakeholders** (page 6)

Sir Donald discussed his view that audit could be improved through enhanced engagement with shareholders. Publishing an audit and assurance policy, for example, would help shareholders provide input on the scope of the audit, as they do on remuneration schemes. Publishing the risk report before the scope of the audit is determined could also stimulate feedback. Several EACLN members were skeptical of such measures. They had concerns about additional information sharing, and they reported that investors have shown little interest in audit issues. Sir Donald acknowledged their doubts but suggested that providing additional information and influence over the audit might lead gradually to improved engagement, as an increasingly relevant audit report would stimulate more interest. Over time, he noted, growing investor input could fill a vacuum that might otherwise be a tempting target for government intervention once current distractions subside.

For a list of discussion questions for audit committees, see Appendix 3, on page 11.

Background of the review

The Brydon review emerged against a backdrop of vigorous debate about the audit profession in the United Kingdom. It joined two other major reviews of auditing: Sir John Kingman's investigation into the FRC, which regulates audits in the United Kingdom, and a competition probe of the audit market by the UK Competition and Markets Authority. The Brydon review took on a third area of concern: the actual conduct of audits by audit firms and the oversight of these audits by company boards, especially audit committees. The terms of reference explain its far-reaching objectives:

The review is intended to take a fresh look at the scope of the audit, how far it can and should evolve to meet the needs of users of accounts, what other forms of assurance might need to be developed, and to define and manage any residual expectations gap. It will test the current statutory audit model and ask whether it can be made more effective as currently established or whether it requires amendment. It will consider how the audit product should be developed to serve the public interest in future, taking account of changing business models, new technology and stronger public expectations.²

In the meeting, Sir Donald summed up the ultimate goal of his review by articulating a vision of an audit that provides information that helps answer three questions: (1) Is the company being honestly run? (2) Does it have a reasonable chance of survival? (3) Is the information the company is providing useful for decision making?

The review requested input on a range of topics from anyone with a direct or indirect interest in audit. Responses arrived from 120 stakeholders, including companies, audit firms, and shareholders, as well as academics and professional bodies, among others.³ One response

was from the Audit Committee Chairs' Independent Forum, an independent forum focused on FTSE 350 company audit committees, and audit committee chairs signed or cosigned some of the company responses. Sir Donald also convened over 100 meetings and roundtables with interested parties.⁴ Some EACLN members provided input.

The final report is a 136-page document containing a wealth of findings and reflections on how audit works in the United Kingdom today. It offers 64 recommendations for improving audit. Most focus on the auditor and the audit committee, and they are detailed and comprehensive in addressing the roles played by both parties.

Though the state of audit in the United Kingdom was the primary focus of the review, several responses came from outside the country, and Sir Donald noted that his recommendations could also apply to other jurisdictions, many of which have experienced similar problems. Some EACLN members expressed doubts about direct applicability in continental Europe, but at least one non-UK member who had read the report remarked on how useful it could be for audit committees outside the United Kingdom.

In conversations before the meeting, a few members were curious about which of the many recommendations were most important to Sir Donald: *"If he were the one to decide, what would be the top three or five?"* Sir Donald responded, *"I've not fallen into the trap of prioritizing my recommendations; they're part of a jigsaw, all hanging together as a whole."*

Others wondered whether the overall approach puts too much emphasis on new rules and regulations, or *"form over substance,"* when the focus should be on leadership and actual behavior—*"having the right quality of people, the right ethics and standards."* A member remarked, *"Some of the recommendations are very logical, but they need to make sure they don't become check-the-box exercises."*

At the time of the meeting, future steps included both legislation by the British government and voluntary action by auditors and directors to implement the report's recommendations. The government was expected to issue a consultation document before the end of 2020. Additionally, the FRC has launched a review in response to the report's recommendations on fraud.⁵

Sir Donald expressed frustration that, while there had been much discussion and study, the government's formal response has been delayed. For companies as well as for the government, the turbulence stemming from both Brexit and the COVID-19 pandemic has undoubtedly shuffled priorities and drawn attention away from audit issues. With multiple reviews in circulation, companies were also waiting for clarity regarding what exactly they should be doing.

The corporate audit

The Brydon report offers a "fresh definition of purpose"⁶ for audit, which entails broadening both the scope of the audit and the information brought to bear on it. The idea is to go beyond the financial-statement audit to establish a more comprehensive "corporate audit" that includes wider aspects of a company's reporting and operations. EACLN members' discussion with Sir Donald explored several aspects of this proposal.

Extending the audit

Sir Donald noted that financial statements based on International Financial Reporting Standards (IFRS) are often insufficient: *“In the UK, the arcaneness of IFRS means that the financial statements don’t immediately provide the signposts that shareholders want.”* This shortcoming has meant that investors and others often turn to alternative performance measures (APMs) and other metrics and information to improve their understanding of the companies in which they have a stake. Broadly conceived, such measures might include APMs as narrowly defined as well as non-financial metrics such as key performance indicators and environmental, social, and governance (ESG) indicators.

But if these kinds of measures are becoming more important now, Sir Donald noted, their reliability also becomes more important: *“It’s demonstrably obvious that the APMs should be held to the same standard of quality [as IFRS-based financial statements].”* Without comparable assurance on APMs and other measures, the temptation to manipulate them becomes greater, with predictable consequences. *“I think the next big scandal will be around greenwashing,”* Sir Donald warned, referring to the significant expansion in recent years of various forms of environmental reporting. EACLN members strongly agreed that APMs and other information outside the financial statements should be audited. *“This is something we have to do,”* one member said.

Moving forward without established standards

However, implementing a level of assurance that matches the assurance applied to financial statements presents difficulties, including the lack of authoritative standards. Sir Donald noted, *“We found that all the Big Four welcomed the idea but said that it’s impossible because there are no standards; they said that they can only audit against standards. So APMs are not being audited.”* Sir Donald argued that auditors should nevertheless move forward, drawing on their broader capabilities: *“It’s part of a bigger problem: the desire for everything to be precise to a standard. But that attitude gets in the way of the provision of professional judgment.”* Ultimately, *“auditors have to be able to audit without clearly defined standards.”*

Several EACLN members acknowledged the challenge but agreed with Sir Donald: *“I realize that for auditors to begin to audit the whole spectrum of performance and ESG data and all of that, it’s a change in their mandate,”* one member said, *“but if we want to wait for audit standards, it will take forever. We as corporate boards have to question that direction.”* Several others noted that their companies were already implementing some level of assurance—or at least some form of review—for the APMs and other measures they publish. *“We have discussions with auditors on whether there’s clarity, and they’re giving commentary,”* one member said. EY has confirmed that assurance practices for these kinds of measures are being developed and applied for an increasing number of clients.

Sir Donald and the members did support the development of standards for both reporting and auditing information beyond the financial statements. Sir Donald endorsed the idea of having a body similar to the International Accounting Standards Board (IASB) develop global sustainability reporting standards, a possibility that the IASB’s oversight body, the IFRS Foundation, is currently exploring.

Improving the capabilities of auditors and audit committees

Sir Donald and the members acknowledged that a wider scope for the audit would require both auditors and audit committees to expand their capabilities beyond the realm of financial statements. He highlighted a major theme of his report: *“It’s important to call out that there’s no audit profession as such.”* Formally, auditing is not a profession distinct from accounting, even though it requires different skills and expertise. As Sir Donald stated in his report, *“auditors need to be professionals in their own right, not just as a part of another profession.”*⁷ Establishing an auditing profession with its own principles and qualifications would elevate the capabilities of auditors.

The broad range of capabilities needed, however, means that other kinds of firms besides audit firms might provide auditing in certain areas, such as cybersecurity or ESG reporting. *“There needs to be independent assurance, but not necessarily from the auditor,”* a member said. As Sir Donald noted in his report and in the meeting, these specialty auditors would be part of the new audit profession and its training and qualifications regime, even if they are not employed at traditional audit firms.⁸

Boards and audit committees face a similar challenge, EACLN members noted. They suggested that the composition of audit committees might have to evolve to meet an expanded audit remit. Alternatively, committees could meet the challenge of overseeing the broader corporate audit by seeking assistance from independent advisers with expertise in key areas. A member observed, *“When boards are considering board composition, often the focus is mainstream business-sector skills like auditing and accounting. So, I’m thinking it could be useful for audit committees to appoint independent people to those committees as advisers who are not board members, thereby supplementing the oversight and monitoring skills without expanding the boards themselves.”* The member added, *“For remuneration committees, often they have external advisers—individuals or organizations—and it’s no different for audit committee. Sometimes technical expertise can bring considerable benefit.”*

Sir Donald welcomed the suggestion: *“I think advisory boards focused on science and technology are very helpful ... Giving them an oversight role has challenges but would be interesting to explore. It’s about reshaping boards and the qualifications for non-executive directors.”* Several members were also agreeable, though some sounded a note of caution regarding the tasks the audit committee should shoulder: *“Some responsibilities which we are discussing should be part of the total board’s responsibility in the future.”*

Sir Donald noted that some proposals lead naturally to a broader discussion of how boards organize themselves. This was not a focus of his review, but he offered some observations on how committees had emerged and evolved: *“The structure of boards is beyond my remit, but a question is, Why do we have these committees? We used to have boards that were ambassadors, but they didn’t do much. Then they got more work, so they set up smaller groups—committees. The Cadbury Report of 1992 institutionalized committees out of necessity for remuneration, audit, etc. Then we gave those bodies more to do. I encourage all members of boards to attend all committee meetings, or you won’t understand what they’re doing well enough.”*

Engaging with stakeholders

The Brydon report observed that shareholders and other stakeholders often fail to engage on audit and risk issues as extensively and effectively as they could, which limits their ability to understand companies' activities and provide thoughtful suggestions. One of the report's major recommendations is to spark interest and engagement in audit matters by providing more information on the company's approach to the audit. *"I came up with the idea of an audit and assurance policy, laying out what is opaque to investors today, and inviting them to respond so they can express opinions about it, as they do for remuneration,"* Sir Donald said. *"The policy would describe how auditors are appointed, how they are paid, the scope of the audit, materiality, what is and isn't audited, and I would invite responses. If we started with that policy, we'd get more engagement."*

Sir Donald noted that in addition to flagging potential concerns, feedback on the audit and assurance policy could also help reduce resources allocated to areas and issues of lower risk: *"If the company is performing perfectly and management is trusted, then why not have a lighter touch at lower cost and focus audits on areas of risk?"* This approach would streamline the audit and make it more useful: *"We have to get investors more engaged and cut the audit down so users get what they want."* Lower costs would address the concerns of some members that extending the audit beyond financial statements would increase costs and draw resources away from related functions, like internal audit.

Information other than the audit and assurance policy could also be shared with investors to stimulate feedback. The report recommends, for example, that audit committees describe the content of debates stemming from differences between management and the auditors. Also, shifting when certain information is shared with investors could make it more useful: *"To aid the process, the risk report, which is a live document, could be published before the scope of the audit is determined, so investors can help them communicate about what the audit is. It's a chance to focus results,"* Sir Donald said.

Will more information sharing help?

EACLN members had mixed views on the usefulness of information sharing as a means of increasing stakeholders' engagement in audit matters. Some endorsed the approach and suggested that existing information could be shared more broadly. One member suggested sharing reports from the auditor to the audit committee: *"Why don't we reform what's already in place? The audit committee already receives the additional report from the external auditor. That doesn't go to the outside world, but it could. It describes significant deficiencies about financials. Those can talk about financials, but also the need to reinforce audit committee work or other committee work. It talks about business continuity. That report could go to the outside and give comfort about internal governance."*

However, other members had doubts about additional information sharing. Some questioned the value of the risk report for shaping the audit, and members were unanimously opposed to sharing audit committee meeting minutes, even with a lag of 12 to 18 months and appropriate redactions. They believed that doing so would inhibit frank discussion in the committee. In the

meeting, Sir Donald softened his stance on this proposal, acknowledging that it had encountered considerable resistance and was *“clearly not going to happen.”*

Are investors really interested?

Several members suggested that more information sharing would ultimately be pointless because investors are not really interested in going deeper on audit. One member observed, *“We’ve had three years of reporting on KAMs [key audit matters] now. I’ve never heard a question at the AGM about that from investors. There is no real interest from shareholders and I ask, Why do we do this? We are providing more reports that shareholders are not digesting. We have to concentrate on issues that are necessary to them.”* Another member was very willing to go deeper with investors but had also seen little substantive interest: *“I would be happy to discuss serious matters. I long for the day when the value of having shareholders at the meeting exceeds the costs of putting it on.”*

Sir Donald allowed as to how he too had been struck by how little investors sometimes understand about what boards do, and he acknowledged members’ doubts about investors’ interest in audit. But he also suggested that providing additional information and influence over the audit might start a process of gradually improving engagement, as an increasingly relevant audit report stimulates more interest. Over time, Sir Donald suggested, growing investor input could fill a vacuum that might otherwise be a tempting target for government intervention once current distractions subside. Even small moves to encourage such a development might be helpful: *“Each measure might not be value added but could be the beginnings of a bulwark against something much worse.”*

Sir Donald also brought up the possibility of engaging other kinds of stakeholders. He described the input one of his boards had recently sought from employees: *“They shared views about the company and the frustrations in their daily lives. They talked about risks that the board wasn’t focusing on, and when we go to the scope of the next audit, that voice will influence it. I wouldn’t shut off that communication. It’s to make a channel available.”*

Conclusion

Sir Donald noted that his review of auditing was animated by a simple principle: *“The information given to users should help them make decisions.”* EACLN members endorsed this principle, and they generally welcomed Sir Donald’s recommendations for applying it. They agreed that the scope of audit should extend beyond the financial statements to create a broader “corporate audit” that includes a variety of other metrics. Implementing this extension should not await new standards, but it will likely require enhanced skills and expertise from both auditors and audit committees. Sir Donald also suggested that more engagement with investors could help focus the audit to meet their needs better. Though members questioned the level of interest in audit among investors, Sir Donald suggested that providing more information might spark a cycle of steadily increasing involvement. Overall, the changes advocated by the report would be significant, but Sir Donald noted that many of them have the benefit of being driven by stakeholders rather than imposed by the government.

About this document

The European Audit Committee Leadership Network is a group of audit committee chairs drawn from leading European companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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Appendix 1: Biography of Sir Donald Brydon

Sir Donald, the current chairman of the Sage Group, conducted the Independent Review into the Quality and Effectiveness of Audit. The product of that effort, *Assess, Assure and Inform: Improving Audit Quality and Effectiveness*, was published in December 2019.

Sir Donald has wide experience gained on the boards of listed companies across a broad range of sectors. He has served as chairman and chief executive at BZW Investment Management and AXA Investment Managers and as chairman of the board of the London Stock Exchange Group, Smiths Group, the London Metal Exchange, Taylor Nelson Sofres, Amersham, AXA Framlington, and Royal Mail. He has also served as a director of Aberdeen UK Tracker Trust, Allied Domecq, AXA UK, and Scottish Power.

Currently he also chairs the board of the charity Chance to Shine and the board of the Science Museum Foundation.

Appendix 2: List of participants

The following EACLN members and EACLN alumnus participated in part or all of the meeting:

- Jeremy Anderson, UBS
- Werner Brandt, Siemens
- Julie Brown, Roche
- Aldo Cardoso, Bureau Veritas
- Laurence Debroux, Novo Nordisk
- Carolyn Dittmeier, Assicurazioni Generali
- Liz Doherty, Novartis and Philips
- Eric Elzvik, Ericsson
- Byron Grote, Tesco, Akzo Nobel, and Anglo American
- Margarete Haase, ING
- Marion Helmes, Heineken
- Liz Hewitt, National Grid
- René Hooft Graafland, Ahold Delhaize
- Shonaid Jemmett-Page (EACLN alumnus)
- Dagmar Kollmann, Deutsche Telekom
- Peter Löscher, Telefónica
- Benoît Maes, Bouygues
- René Médori, Vinci
- Ana de Pro Gonzalo, STMicroelectronics
- Mariella Röhm-Kottmann, Zalando
- Sarah Russell, Nordea Bank
- Guylaine Saucier, Wendel
- Erhard Schipporeit, RWE
- Carla Smits-Nusteling, Nokia
- Alan Stewart, Diageo

The following North American Audit Committee Leadership Network (ACLN) member participated in part or all of the meeting:

- Pam Daley, BlackRock

The EY organization was represented in all or part of the meeting by the following:

- Marie-Laure Delarue, EY Global Vice Chair – Assurance
- Jean-Yves Jégourel, EY Global Vice Chair – Professional Practice
- Julie Teigland, EY EMEIA Area Managing Partner

Appendix 3: Discussion questions for audit committees

- ? What questions or comments do you have regarding the overall objectives of the Brydon review?
- ? What would you like to understand about the methodology of the review and how Sir Donald arrived at his conclusions?
- ? Is a broader vision of audit a good idea? What are the benefits and pitfalls?
- ? How will these recommendations affect the audit committee? What challenges would their implementation bring?
- ? How much interest do you believe shareholders and other stakeholders have in audit? Have you had interactions with them in your role as audit committee chair?
- ? Will the Brydon report's recommendations improve stakeholder engagement and the audit?
- ? Would a resilience statement be valuable? What are the challenges of drawing up such a statement?
- ? How can the auditor contribute to a resilience statement? What kind of assurance from the auditor would be appropriate?
- ? How does your company negotiate fees for audit work? What aspects of the process could be improved?
- ? What is the proper role of the auditor in detecting fraud? What can they realistically do?
- ? What can the audit committee do to improve fraud detection?
- ? Some of Sir Donald's recommendations have already been implemented by many companies. Among the ones that have not been implemented at your company, which two or three would you be most likely to implement voluntarily?

Endnotes

¹ *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from conversations with network members and Sir Donald in connection with the meeting.

² "[Independent Review into the Quality and Effectiveness of Audit: Call for Views](#)," gov.uk, April 10, 2019, 48.

³ "[Consultation Outcome: The Quality and Effectiveness of Audit: Call for Views](#)," Department for Business, Energy & Industrial Strategy, updated December 18, 2019.

⁴ Sir Donald Brydon, CBE, *Assess, Assure, and Inform: Improving Audit Quality and Effectiveness; Report of the Independent Review Into the Quality and Effectiveness of Audit* (London: Crown, 2019), 18.

⁵ Tabby Kinder, "[UK Regulator Proposes to Beef Up Auditors' Obligation on Fraud](#)," *Financial Times*, October 21, 2020.

⁶ Brydon, *Assess, Assure, and Inform: Improving Audit Quality and Effectiveness*, 7.

⁷ Brydon, *Assess, Assure, and Inform: Improving Audit Quality and Effectiveness*, 30.

⁸ Brydon, *Assess, Assure, and Inform: Improving Audit Quality and Effectiveness*, 8.