

Brexit: Financial reporting implications

Audit Committee Institute

As businesses develop their responses to the outcome of the UK referendum on continued EU membership, the business-as-usual of preparing financial reports and auditing continues. There are some immediate accounting and reporting implications to consider when preparing half-yearly and annual financial reports.

It will be some time before the longer-term effects of the UK referendum result become clear. However, in the short-term, elevated geopolitical instability and economic uncertainty will result in increased market volatility for asset prices and exchange rates *inter alia*.

As a consequence, audit committees will be assessing the impact of the increased economic uncertainty and market volatility on interim and annual financial statements; and ensure management are monitoring developments to assess what impact, if any, these have on the business model, strategy, business plans, forecasts and financial reporting.

Communicating impacts and implications

Following the referendum result, and as the UK moves towards exit, investors will want to understand how business models of companies active on UK markets are exposed to each new opportunity and risk. Transparent business model disclosure and clarity over longer-term strategy will be more important than ever during this period of uncertainty.

In both annual and half-yearly reporting, companies may need to reassess their principal risk disclosures in the context of the changed global business environment. Does 'brexit' give risk to new risks to shareholder value, or change the scale and likelihood of existing risks?

The focus on communication of the implications of the referendum result also extends into the financial statements. Disclosures of accounting judgements, sources of estimation uncertainty and financial instrument risks may also need to be revisited. We may well see increased disclosure of sensitivities of estimates to changes in assumptions – and of more key assumptions being identified for disclosure.

Though challenging, articulating the potential impact on the business model and longer-term strategy with as much clarity as possible will be more important than ever during this period of uncertainty.

Companies should consider whether their front-end narrative provides sufficient information to allow the implications of uncertainties, exit terms and strategic responses to be assessed.

Does reporting provide sufficient information to enable shareholders to assess the implications of exit scenarios, and is the tone and balance of the discussion appropriate? Companies are not required to quantify potential future performance impacts, but should provide relevant factual information to enable users to form their own assessment, for example through business model disclosures.

Narrative reporting



Financial statements



Accounting in an environment of uncertainty and market volatility

Uncertainty and volatility put particular pressure on financial statement measures and forward-looking assessments such as asset valuations, inventory values, consideration of onerous contracts, deferred tax asset recognition, recoverability of receivables, hedge effectiveness testing and even the going concern assessment and covenant compliance.

Perhaps the greatest focus will be on impairment tests. There are various factors to consider, for example:

- Updating cash flows in value in use calculations: while long term implications may not be clear, and there are limitations on taking any planned restructurings into account, cash flow forecasts may still need updating to reflect changes in the competitive environment, growth rates or exchange rate implications.
- Determining discount rates: incorporating changes in risks and market conditions.
- Determining which assets are tested for impairment: do changes in the market, or in internal expectations mean that more assets need to be tested for impairment?

Valuations of assets or liabilities, such as properties, pension balances, or financial instruments will also be affected by market activity and so particular focus on the approach taken and assumptions used can be expected.

Together with foreign exchange implications, variability in such valuations might be expected to be one of the greatest areas of focus as users look at the impact on financial statement balances.

June year ends and half-yearly reports

For 30 June year ends or half year reports, valuations and estimates involving observable market transactions may have more limited available relevant information at that date, and updated valuations may be required.

Half-yearly reports at this date could be expected to include additional discussion of factors relating to the referendum result. Is the required explanation of events relevant to understanding the position of the entity complete – particularly where exchange rates have a significant impact, circumstances affect the fair value of financial instruments or where estimates have changed.

Audit considerations

Audit plans – both internal and external – may need to be revisited in the light of the uncertainty resulting from the UK referendum result.

For internal audit (and other internal assurance providers), question whether the plan continues to be focused on the key risks facing the business. Should some audits be accelerated? Does more need to be done around contingency planning or the robustness of key risk indicators which provide early warning of issues on the horizon?

Question whether the external auditors are still focused on the right audit risks. How have the changes to the geopolitical and economic environment been factored into the audit plan and are the planned responses to risks still appropriate? What impact does the increased uncertainty and market volatility have on the scope of the audit and audit materiality?

Consider whether the audit should be deploying more specialist expertise in the light of the impact on pensions, financial instruments and other valuations?

Are your auditors keeping you apprised of how their audit plans are changing? Do the changes accord with your understanding of how the uncertainties associated with Brexit are impacting your business model, strategy and the principal risks facing the business?

