

Disruptive trends: Geopolitics

Disruption on multiple fronts is putting audit committees on high alert

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Political and economic risks are increasingly becoming audit committee agenda topics, with large enterprises implementing sophisticated models to analyse them.

Economic volatility

The global economic environment has become extremely complex, as have the implications for UK businesses. While there are distinct opportunities around mergers, consolidations, building synergies and cutting costs, both the pound and commodity prices remain difficult to predict. Mining and energy are suffering while some other sectors are benefiting. Amid these conflicting trends and confusing economic data - where risk can be rapidly heightened or diminished depending on the sector - audit committees need to be cognisant of global volatility as it relates to their own organisation's business model and strategy.

Emerging markets risks

Companies are looking to access emerging markets, but the question of how to play in those markets and what risks they raise is key. It's important to balance your exposure in good and bad times and given current economic challenges, audit committees may want to scrutinise their organisations' new market entry plans more carefully. How will management mitigate new risks? Do they fully understand them? How effective are existing controls? Are more controls needed? And if the company already operates in volatile markets, should a review of risk management in those jurisdictions be undertaken?

Geopolitics

Brexit, the refugee crisis, conflict in the Middle East and China's economic sluggishness are just some of the issues shaping the geopolitical landscape. While some of these global issues are generating more traditional geopolitical risks, events such as the massive demographic shift created by the refugees crisis - and the pressures that they are creating in Europe - are different and should be addressed.

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Even though China's economy is growing faster than the rest of the world, international stock markets came to a virtual standstill when China's market dropped, significantly resetting global trade dynamics. Factor in the enormous uncertainty surrounding the EU referendum and the US election and what impact the results may have and its clear geopolitical instability needs to remain on the audit committee radar.

At the time of writing, fewer than half the FTSE 100 make reference to the EU referendum in their most recent annual reports. Does this mean that the risk of Brexit has been assessed, but not considered a principal risk? Or does it mean that risk management systems have failed to identify and assess 'Brexit risk' or at least are 'late to the game'?

Year end	Referring to Brexit risk
March to November 2015	12%
December 2015	37%
January to March 2016	50%

Industries in crisis

For some industries, the intrinsic question of disruption and risk has had to be put on the back burner. Audit committees and boards at oil and gas and mining companies are already dealing with large-scale disruption of the economic and financial models they rely on. These organisations are focusing on issues such as financing, impairments and cost reduction initiatives. However, cost and headcount reductions can have significant impacts that companies may not always foresee. Internal controls, for example, may be impacted as the individuals tasked with executing on them may have changed positions or left the organisation. Audit committees should make sure they understand these potential impacts and are comfortable that remedial measures are in place.

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