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. As the FRC highlight in their recent press release, 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 political instability and economic uncertainty will result in:

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- increased market volatility for asset prices and exchange rates;
- potentially higher UK inflation as a consequence of sterling depreciation;
- credit rating downgrades and certain sectors potentially experiencing increased difficulty in obtaining or renewing credit;
- changes to the capital buffer for UK banks;
- declines in some property values, with increased investor withdrawals leading to restrictions on redemption requests from some property funds; and
- expectations that investment and acquisition activity could be curtailed until the uncertainty subsides, contributing to lower short-term economic growth forecasts and higher risk premiums.

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 companies’ business models are exposed to each new opportunity and risk.

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 the strategic report 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.

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

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At the time of writing, fewer than half the FTSE100 make reference to the EU referendum in their most recent annual reports. Does this mean that companies did not ‘pick up’ on Brexit risk, or that the risk had been assessed, but was not considered a principal risk?

<table>
<thead>
<tr>
<th>Year end</th>
<th>Referring to Brexit risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>March to November 2015</td>
<td>12%</td>
</tr>
<tr>
<td>December 2015</td>
<td>37%</td>
</tr>
<tr>
<td>January to March 2016</td>
<td>50%</td>
</tr>
</tbody>
</table>
June year ends and half-yearly reports

For 30 June year ends or half year reports, many of the issues discussed in this paper may be heightened. For example, valuations and estimates involving observable market transactions may have more limited available relevant information at that date, and updated pension 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. Regulations also require principal risk disclosures to be updated if they are different in the second half.

Audit considerations

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

For internal audit (and other internal assurance providers), question whether the plan continues to be focussed 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 focussed 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 appraised 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?

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