



# ***Brexit-Related Audit Considerations***

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# *Introduction*

- This webinar is based on material in ICAEW's Brexit hub. It is intended to help SME auditors deal with current Brexit-related uncertainties associated with a potential no-deal exit as they affect 31 December 2018 and 31 March 2019 audits.
- We do not deal with the longer-term potential opportunities or risks associated with Brexit more widely.

# *Outline*

1. Brexit-related audit risk factors.
2. Corporate reporting.
3. Auditing standards.
4. 10 key questions for a consistent audit approach.



# *Brexit-related Audit Risk Factors*

# ***Brexit-related audit risk factors***

- Brexit likely to affect many entities commercially and operationally.
- Nature and extent of effects uncertain, but entities need to analyse and sensitise key risks arising from a variety of possible Brexit scenarios.
- Auditors need to identify and assess uncertainties with the potential to materially affect the financial statements.

# ***Brexit-related audit risk factors – entity specific***

**Entity-specific** uncertainties include **wider supply chain issues**, such as the size, location and nature of business - e.g. channel port hauliers vs software developers using US labour.

The Department for Exiting EU has issued 100 technical notices - general and sector-specific - on *how to prepare if UK leaves EU with no deal*.



# ***Brexit-related audit risk factors – sector specific***

**Specific sectors** in which RoMM and going concern assessments may be affected by Brexit:

- retail, food, others with fast-moving inventory bought from/sold to EU;
- pharmaceuticals, chemicals, others depending on EU licensing;
- aquaculture and agriculture depending on EU quotas, labour or markets;

## ***Brexit-related audit risk factors – sector specific (continued)***

- airlines, hauliers operating between UK, EU;
- biomedical, others dependent on EU tax incentives for R&D;
- hospitality, travel, entertainment, others affected by perceptions of economic well-being;
- others depending on tight cash flows;
- entities invested in/with significant property portfolios, including public sector, pension funds.

# ***Brexit-related audit risk factors - estimates***

**Estimates** affected by Brexit-related uncertainties include:

- asset impairments;
- going concern;
- fair value calculations;
- loss provisions in contract accounting;
- recovery of deferred tax assets.

# *9 potential Brexit-related audit risk factors for the risk assessment*

1-3

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1. Increased import costs, tariffs and duties;
  2. Increases in tariffs, duties on exports;
  3. Effects of 1-2 on fulfilment of contractual delivery, quality and supply obligations, risks associated with breaches of contract;

# *9 potential Brexit-related audit risk factors for the risk assessment*

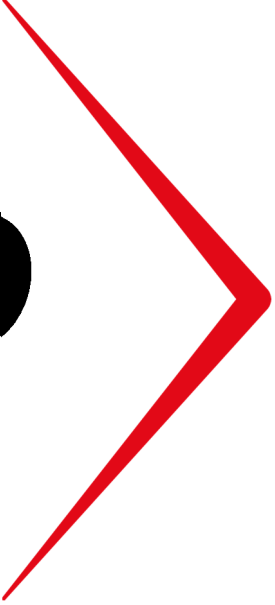
**4-6**



- 4. Impaired market access for businesses dependent on 'passporting' rights under EU law.
- 5. Restricted access to EU for long term business purposes, work permits.
- 6. Changing value of sterling, unemployment and inflation.

# *9 potential Brexit-related audit risk factors for the risk assessment*

7-9

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- 7. Increased regulatory and compliance risks.
  - 8. Loss or increased cost of EU labour and changes in employment contracts.
  - 9. Legal & compliance issues: restructuring to move operations or admin in or out of the EU.



# *Corporate Reporting*

# *Corporate reporting - FRC*

- FRC October 2018 letter describes expected disclosures. Subsidiaries will provide information to parents, unlisted entities may include Brexit-related principal risks and disclosures.
- A challenge for listed company boards for 31/12/18 accounts - published shortly before 29/3/19.



# *Corporate reporting - FRC (continued)*

FRC wants disclosure of:

- specific, direct challenges to business model, operations, not broad economic uncertainties;
- actions mitigating/managing potential impact - including recognition/re-measurement;
- sensitivity analyses, including wider-than-usual range of possible outcomes for cash flow projections.

While not all companies will require extensive disclosure: Next Plc: Brexit Preparation Impact Analysis

# ***Corporate reporting – going concern***

## **Going concern, viability, impairments**

- Operational issues, cash flows - increased costs, revenue loss, exchange rate changes - are key.
- Evidence supporting impairment models, assumptions, value-in-use calculations, changes to classification of cash generating units?
- Management resistance to disclosure based on risk mitigation, commercial sensitivity?

# ***Corporate reporting - going concern (continued)***

- **Impairments** affected by revenue growth assumptions. Are uncertainty, risk accounted for in cash flow forecasts, discount rates?
- Consider recoverability of deferred tax assets, pension deficits valuations, particularly if invested in property. Stock NRV affected by shipping delays?
- Consider investments in subsidiaries, associates, JVs, the ECL model and expectations about economic environment, such as likely default rates...

# *Corporate reporting – tax and dividends*

**Tax:** risk of increased tax liabilities if EU-related tax reliefs fall away. Has management considered how these can be settled? When? Going concern issues?

**Dividends:** risk of unlawful dividends if directors do not account for losses between y/e and payment date under common law, or fail their fiduciary duty to consider whether the dividend payment might threaten future solvency.

# ***Corporate reporting – smaller entities***

## **Smaller entities, FRS 102, FRS 105**

- Overriding requirement for all financial statements, including abridged accounts, to be true and fair.
- If Brexit-related issues impact this, the fact that disclosure is not specifically required is not relevant.
- FRS 102 requires financial statements to give a true and fair view, FRS 102 section 1A requires additional disclosures, if necessary, to give a true and fair view, FRS 105 assumes a true and fair view if complied with.

# ***Corporate reporting – smaller entities (continued)***

- FRS 102 para 8.7 requires *‘...key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.’*
- Not required under S1A for smaller entities, but auditors may suggest management considers disclosure to show consideration of Brexit, and that related risks are being managed, e.g. disclosing sensitivity of debtors to sharp exchange rate fluctuations.

## ***Corporate reporting – smaller entities (continued)***

- All entities required ('encouraged', FRS 105), to disclose material uncertainties related to events/conditions that may cast significant doubt on going concern.
- Many smaller entities file 31/12/18 accounts after 29/3/19. Which Brexit-related events/conditions should be adjusted for, which disclosed?



# *Auditing Standards*



# ***Auditing standards – quality control***

## ***ISQC 1 and ISA 220: Quality Control***

- Brexit issues to be considered for inclusion as a ‘mandatory’ issue to be addressed during the audit?
- Encourage internal consultation on the technical aspects of Brexit as part of quality control procedures?
- Take Brexit considerations into account when selecting files for hot, cold, and engagement quality control and any other reviews?

# ***Auditing standards – going concern***

## ***ISA 570 Going Concern***

- Cash flow forecasts: ‘sensible look’ at downsides?
- Additional working capital requirements, danger of breaching covenants? Brexit may be final straw for some.
- **Mitigating factors:** evidence needed to support assertions about, e.g. focus on other markets, opening/closing offices in EU.

# ***Auditing standards - going concern (continued)***

**Disclosures:** of Brexit-related issues generally, and of going concern issues in particular may involve difficult discussions with, and challenges to, management.

# ***Auditing standards – subsequent events***

## ***ISA 560 Subsequent Events***

- Approval of accounts, audit report, pre- or post 29/3? Minimise delay between the two?
- Any difference if no-deal Brexit is adjusting or non-adjusting event?
- Determine in advance what constitutes adjusting, non-adjusting events.

# ***Auditing standards – reporting***

## ***Reporting: Key Audit Matter (KAM), Emphasis of Matter (EoM), Other Matter (OM)***

- If qualification necessary because of inadequately disclosed material uncertainty relating to going concern, do not use KAM, EoM, OM.
- Use EoM to draw attention to significant but properly disclosed uncertainties. The ‘fundamental’ (to users’ understanding) test for an EoM is a high hurdle.

# ***Auditing standards – reporting (continued)***

***‘Other matter’ paragraphs*** are matters:

*...other than those that are presented or disclosed in the financial statements that, in the auditor’s judgment, are relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report.*

***Might Brexit-related issues always be covered, as KAM, EoM or OM?***

# ***Auditing Standards - reporting (continued)***

## **The impact of uncertainties due to Britain exiting the European Union on our audit**

Uncertainties related to the effects of Brexit are relevant to understanding our audit of the financial statements. All audits assess and challenge the reasonableness of estimates made by the directors, such as recoverability of investments, intangibles assets and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the company's future prospects and performance.

Brexit is one of the most significant economic events for the UK, and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown. We applied a standardised firm-wide approach in response to that uncertainty when assessing the company's future prospects and performance. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

# ***Auditing standards – analytical procedures and estimates***

***ISA 520 Analytical Procedures:*** may involve predicting likely results, Brexit makes it harder.

***ISA 540 Accounting Estimates:*** review of process for developing estimates - exercise scepticism by ensuring that downside has been considered, focus on disclosure of assumptions.



# ***Auditing standards – written representations***

## ***ISA 580 Written Representations***

Consider obtaining these for management intentions re. assumptions about Brexit, mitigation of potential adverse effects. Consider history, reasons for choosing a course of action, ability to pursue that course.

Written representations no compensation for Brexit-related risk assessments not performed, assessments that are insufficiently robust, where conclusions drawn are inappropriate, or if there are residual unaddressed risks.

# ***Auditing standards – confirmations, other information, communications***

***ISA 505 External Confirmations:*** consider obtaining confirmation where Brexit-related issues lead to disputes about e.g. goods incorrectly labelled, spoiled in transit, or regarding who pays tariffs.

***ISA 720 Other Information:*** are Brexit related issues dealt with differently between the financial information and other information?

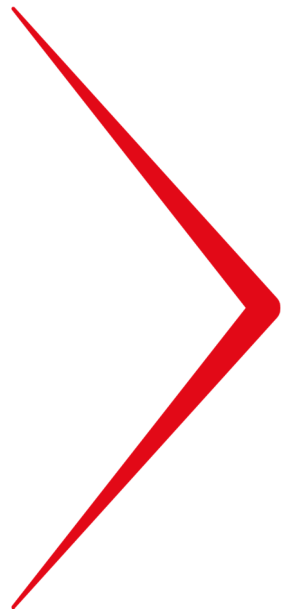
***ISA 260 Communications with those charged with governance:*** Brexit-related issues may be caught under several headings.



# *10 Key Considerations for a Consistent Audit Approach*

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**1- 3**



Consider internal guidance for:

1. engagement quality control reviews:  
how to challenge teams;
2. busy season planning;
3. consistent approaches to common issues, e.g. supply chain management;

# *10 key considerations for a consistent audit approach*


**4 - 6**



4. criteria for determining adequacy of disclosures - Brexit template for Strategic or Directors' reports?
5. advice to clients on additional Brexit-related work they need to do;
6. what management should provide: sensitivity analyses for impairments, contingency planning;

# *10 key considerations for a consistent audit approach*

**7 - 10**

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7. additional work on risk, going concern assessments, quality reviews, particularly for unprepared clients;
  8. independence issues if clients need help;
  9. managing clients where Brexit potentially has significant adverse consequences;
  10. resource planning, budgets and fees, communications generally.

# *Future webinars and events*

## Spring Roadshow Dates

Date	Title	Location
11 March	Essentials CPD 2019: Audit and Assurance Update (Spring)	Preston
12 March	Essentials CPD 2019: Audit and Assurance Update (Spring)	Durham
24 April	Essentials CPD 2019: Audit and Assurance Update (Spring)	Penrith
3 May	Essentials CPD 2019: Audit and Assurance Update (Spring)	London
13 May	Essentials CPD 2019: Audit and Assurance Update (Spring)	Liverpool
20 May	Essentials CPD 2019: Audit and Assurance Update (Spring)	Manchester
4 June	Essentials CPD 2019: Audit and Assurance Update (Spring)	London
6 June	Essentials CPD 2019: Audit and Assurance Update (Spring)	Leeds
13 June	Essentials CPD 2019: Audit and Assurance Update (Spring)	Birmingham
18 June	Essentials CPD 2019: Audit and Assurance Update (Spring)	London
19 June	Essentials CPD 2019: Audit and Assurance Update (Spring)	Leicester

# ***Future webinars and events***

## **Webinars**

Date	Title
29 April	What's new in quality management
27 June	Effective file review

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