The impact of Brexit on corporate reporting

Considerations for preparers and audit committees

July 2017

What does Brexit mean for corporate reporting?

Last year, most companies considered it too early to provide any specific commentary in their periodic reporting on the impact of Brexit. Some companies referred to the uncertainty it had caused but many stayed silent.

Since then, the UK Parliament has voted in favour of triggering Article 50, and on 29 March 2017, the UK Government duly gave the requisite notice, initiating a two year process for the UK leaving the EU. This means that the process of Britain leaving the EU is now legally in place. Following an eight week gap due to the UK General Election, negotiations between the UK and the EU began on 19 June. The deadline for concluding the talks remains as 29 March 2019.

Companies who are planning their 2017 interim financial statements or Annual Report and Accounts (ARA) will need to consider the implications. Whilst not all companies will be impacted by Brexit, it is important for boards and audit committees to consider the reporting implications, if any, in order to comply with regulatory requirements.

We have summarised the key requirements and guidance sources that should be considered in making this determination.

Interim management reports in half-yearly financial reports

Under the Financial Conduct Authority's Disclosure Rules and Transparency Rule (DTR), 4.2.7[1] the interim management report must include:

- An indication of important events that have occurred during the first six months of the financial year, and their impact on the condensed set of financial statements
- A description of the principal risks and uncertainties for the remaining six months of the financial year

In light of these requirements, preparers and audit committees will need to consider whether the Brexit decision and the ensuing process, including the triggering of Article 50 in March 2017, had an impact on the condensed interim financial statements and also challenge whether the principal risks and uncertainties disclosed in the last ARA remain valid or whether some additional risk disclosures are warranted.

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Considering the key requirements of the Companies Act 2006 (in respect of the contents of a Strategic Report) and the Corporate Governance Code, preparers and audit committees should consider the following in analysing whether and where the impact of Brexit should be disclosed.

Requirements under Companies Act s414C: The Strategic Report must contain:	**Considerations for boards and audit committees**
"A fair review of the company's business" "The review required is a balanced and comprehensive analysis of the development and performance of the company's business during the financial year and its position at the end of the year"	Consider whether Brexit has had an impact on the current year's performance and development, and if so, disclose its impact in a balanced manner.
"A description of principal risks and uncertainties"	Consider whether the impact of Brexit represents a change to principal risks in of itself or indirectly, e.g., manifests itself within other risks such as increased foreign exchange risk. The Financial Reporting Council published reminders in July 2016[2] which drew attention to the following: ► Directors should consider the nature and extent of risks and uncertainties arising from the result of the Referendum and the impact on the future performance and position of the business. Those which the board judge to be principal risks and uncertainties should be disclosed and explained. ► Company-specific disclosures are important in understanding how those risks and uncertainties are relevant, given the specific facts and circumstances of the company. ► Boards should be encouraged to provide an explanation of any steps that they are taking to manage or mitigate those risks.
"Information on the main trends and factors likely to affect the future development, performance and position of the company's business (to the extent necessary for an understanding of the development, performance or position of the company's business)"	Where relevant, companies should include some forward-looking analysis and discussion on the likely impact Brexit on the future performance and development. This could feature in a CEO's review or a "markets overview" section of the ARA.

Other disclosure considerations:

- **Business model and strategy:** Brexit could have a direct material impact on some companies' business models. In some industries, e.g., airline, food and hospitality, automotive, manufacturing, financial services, the impact may be more pronounced. Boards need to consider whether specific negotiating issues such as access to the customs union (e.g., changing the costs of imports, etc.,) or access to the EU labour market may impact their business model and consequently whether some disclosures are warranted, i.e., on how specific Brexit issues have affected/will affect their business model, the impact this has/may have on their ability to deliver their strategy and their plans to change/adapt their business model.
- **Basis of preparation of financial statements:** Directors should consider whether disclosures of material uncertainties are needed or whether the going concern basis of accounting remains appropriate. For example, if the ability to obtain finance/re-finance may be affected by risk aversion from lenders during this time of market uncertainty.
- **Viability statement:** Directors[3] should also consider whether there is an impact on the viability statement. For example, if there is a new/heightened principal risk that has arisen as a result of Brexit which impacts the company's solvency or liquidity this will need to be considered in their scenario planning and stress testing. Equally disclosures on assumptions underpinning the viability assessment may need to be reviewed and revised (e.g., the viability assessment could be underpinned by an assumption made by directors on the likely outcome of the Brexit process).

Financial reporting considerations in interim and annual financial statements

There are a number of financial reporting matters directors should be considering when preparing interim and/or annual financial statements in the light of the uncertainties caused by Brexit. Some of the more common issues are considered below.

Recoverability of assets and other balance sheet measurements

The assumptions used to determine the recoverability of assets are put into sharper focus by economic uncertainties such as those arising from or heightened by Brexit. This is particularly relevant for goodwill, intangible assets and property plant and equipment where cash flow forecasts used in value-in-use calculations should be based on the most recent budgets and forecasts, taking account of these uncertainties. For finate life assets, these uncertainties could trigger impairment reviews of assets that are not normally tested for impairment.

Where items are measured at fair value, for example investment properties or equity securities, or impairments of non-financial assets are based on fair values, the assumptions used should make maximum use of market-determined inputs. For example, foreign exchange rates should be based on spot or forward rates at the reporting date, not expectations of what those exchange rates might be in the future.

In addition, forecasts of taxable profits used to support the recognition of deferred tax assets should reflect any changes to the economic outlook for the relevant business that have been brought about or heightened by Brexit. Using appropriate assumptions is also important for assessing the net realisable value of inventories and determining whether loans and receivables and other investments, including those in associates and joint ventures, are impaired.

The impact of Brexit and tax legislation

Tax legislation in EU member states and other countries, contains tax exemptions and tax reliefs (e.g., withholding tax and merger relief) that depend on whether or not the entities involved are EU domiciled. Once the UK leaves the EU, these exemptions and reliefs may no longer apply to transactions between UK entities and entities that remain within the EU. In those cases, additional tax liabilities may crystallise. It is uncertain which of these exemptions and reliefs will be renegotiated as part of the UK's exit.

IAS 12 Income Taxes, the income tax accounting standard, requires entities to measure current and deferred tax at the amount expected to be paid to the taxation authorities, using tax rates and tax laws that have been enacted, or substantively enacted, at the end of the reporting period. However, the triggering of Article 50 gives rise to uncertain tax positions as it raises significant uncertainty about how the existing tax legislation will apply after Brexit. It has also raised uncertainty about the future tax status of entities, which may lead to changes in the accounting treatment. Given the uncertainties around taxation, we expect entities to continue to apply their current accounting policies, until the position becomes clearer. However, the level of uncertainty may require additional disclosure in the financial statements.

As Brexit negotiations progress, the uncertainties about tax legislation and the application of IAS 12 may start to be resolved as each jurisdiction confirms the appropriate tax treatment. Therefore, entities will need to consider the current position at each reporting date and may need to make changes to the accounting treatment and disclosures that have previously been presented.

Disclosures

The consequences of Brexit could have an impact on the significant judgements made in preparing financial statements as well as the sensitivity of key accounting estimates, especially where markets have experienced higher volatility. Therefore companies should focus on the adequacy of their disclosures about judgements, estimates and associated sensitivities and consider whether additional or different information should be given. This applies to both annual and interim financial statements.

What is the impact of the UK General Election result?

The recent General Election result — where no single party managed to win an outright majority — has injected additional uncertainty and instability into the Brexit process. The likelihood of a "softer" Brexit — meaning single market and/or customs union membership has increased — though the central scenario remains a negotiation Free Trade Agreement. A "no deal" scenario also remains a risk. Fundamentally, the result does not change the need for Directors to take into account the impact of Brexit, as discussed above. Legal notice has been given and stands until and unless notice to leave is withdrawn, which at the moment remains an unlikely prospect. Directors should continue to plan on the UK leaving the EU in March 2019.

How we can help

At this time of economic, political, legislative, regulatory and trade change, business decisions are increasingly important and difficult. It is therefore key that businesses are more adaptable, strategic and visionary than ever before and review their methodologies and assumptions. Business leaders must lead more than just business. Leading through disruption requires access to knowledge and information, collaborative management and decision making to allow new ideas and business models to come to the fore. Our International Trade, Economics and Policy unit (ITEP) delivers powerful business insights that can help you better understand the changing landscape and identify growth opportunities. Bringing together a team spanning economics, policy, trade and regulation, ITEP helps businesses, Government and industry bodies to answer the most challenging questions and forge a successful future for the UK in the global economy.

Further information

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References

1. *DTR 4.2 Half-yearly financial reports*, Financial Conduct Authority. Accessed via http://bit.ly/2u4W4F2.
2. *Reminders for half-yearly and annual financial reports following the EU referendum*, Financial Reporting Council (2016). Accessed via http://bit.ly/2t5dnBw.
3. Directors of premium listed companies who are required to comply with the UK Corporate Governance Code or other listed companies who voluntarily elect to do so.

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