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Brexit: Assessing the impact and audit implications

Auditors need to assess the impact of Brexit for their audit clients. In this download, we look at some of the areas where auditors should evidence consideration of the potential implications and areas where implicit uncertainty will impact on the audit approach.

Uncertainty over what a post-Brexit environment will look like makes life as an auditor more difficult in a number of areas. We set out below some of the key implications for auditors and have included a complimentary Brexit Impact Assessment form that can be used to evidence consideration of relevant Brexit-related risk factors and their impact on the audit approach.

Mercia Audit Manual references are included within the guidance below to help subscribers link their consideration of Brexit to documentation on their audit files.

ISA 315 (UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT) AND ISA 330 (RESPONSES TO ASSESSED RISK)

Auditors need to identify and assess relevant Brexit-related implications to the extent that they have the potential to materially affect the operations of the client or its financial statements.

The sector in which a business operates will often have implications for the level of risk, opportunity or uncertainty brought about by Brexit. Further guidance on sectors particularly affected can be found in the ICAEW's **Brexit resources**.

To the right, we have highlighted a number Brexit-related risk factors. These, and other relevant factors should be considered and recorded on the audit file. This can be done in the format laid out on the following page as part of a Brexit Impact Assessment. Once relevant factors are documented, their impact needs to be considered and the auditor's approach tailored as necessary.

Within the Mercia Audit Methodology, relevant risks and the impact on the audit work are transferred to B32, the current year risk assessment, and reflected on relevant individual area audit plans (B33) and work programmes.

Where, the risk factors have a high impact and the entity is considering a change in strategy (eg. relocate to elsewhere in the EU / outside of the EU / change major suppliers / product diversification) then this would be recorded on the Understanding the entity and its environment permanent file documentation (eg. PF1-1/2).

BREXIT RISK FACTORS

General trade

- Ability to fulfil orders where goods held at port (prevalent if using 'just in time' systems), quality of alternatively-sourced products, and potential non-fulfilment of orders
- Costs relating to imported EU goods (eg. data collection, declaration and customs costs at ports and bonded warehouses; costs related to authorised economic operator (AEO) status)

Tariffs and customs

- Cost implications for goods exported to the EU in terms of tariffs
- Costs implications for goods imported from the EU and elsewhere

Capital and skills

- Availability of EU labour and / or related labour cost implications (eg. changes in employment contracts and the cost of EU worker Settled Status applications)
- Market access for businesses relying on 'passporting' rights under EU law (eg. broadcasting, financial services and airlines and hauliers)
- Work permits for UK nationals working or providing services and reciprocal rights for EU nationals

Macro-economic factors

- Foreign exchange fluctuations
- Inflation rates
- Taxation

Policy and regulation factors

- Regulatory and compliance risks where activities governed by EU law (eg. licensing, trademarks and intellectual property, insolvency proceedings and competition law)
- Availability of EU grant and commercial funding
- General data protection regulations (GDPR) - UK Data Protection legislation and regulations are presently based on the EU GDPR

EXAMPLE BREXIT IMPACT ASSESSMENT FORMAT

REF

Objective: To assess the impact of Brexit on the entity.

Brexit impact assessment *Identify Brexit-related risk factors and assess the impact.*	
Risk Factors	**Impact**

An appropriate response to these areas is set out on [B32/B33].

Prepared by: ______________________________ Date: __________

Reviewed by: ______________________________ Date: __________

Depending on the level of uncertainty, the above impact assessment may need to consider variable Brexit outcomes and their respective potential implications for the client. This uncertainty will also likely impact on the approach taken as part of the audit and may also influence consideration of going concern as noted below.

ISA 570 (Going Concern)

Auditors will need to consider Brexit-related risk factors and their impact on the individual entity in order to appraise its going concern status and the presence of material uncertainties. In addition to those specific risk-factors, entities that are already struggling, such as those close to their borrowing limits or covenant limits will require close attention.

Where going concern is highlighted as a risk, this will be reflected in the nature, scope and timing of procedures performed. Appropriate sensitivity analysis of various scenarios is likely to be required which would normally be evidenced on separate documentation that supplements conclusions drawn on going concern forms (eg. A42) completed as part of the engagement.

Disclosures of going concern issues in relation to Brexit may be a contentious issue for auditors and clients. Auditors must challenge clients in this area, especially where only high-level generalised disclosures are made.

Implicit levels of uncertainty may also hold implications for the auditor's report with material uncertainty leading to significant doubt over the ability of the entity to continue as a going concern normally leading to one of three situations from a reporting perspective:

- Unmodified opinion (with material uncertainty going concern paragraph): a material uncertainty exists and is adequately disclosed in the financial statements
- Qualified opinion: a material uncertainty exists and there is inadequate disclosure concerning that material uncertainty
- Adverse opinion: a material uncertainty exists and is not disclosed in the financial statements

ISA 250A (Laws And Regulations)

Through reviewing the Brexit risk factors, auditors also need to ensure that documentation on laws and regulations (eg. PF1-3) accurately reflects the current laws and regulations that have a direct effect on the determination of material amounts and disclosures in the financial statements.

ISA 500 (Audit Evidence) And ISA 540 (Accounting Estimates And Fair Value)

Implications of Brexit may mean recognising or remeasuring certain items in the balance sheet. Affected items are likely to include estimates and / or fair values with auditors needing to consider questions such as:

- Will fixed assets need to be appraised for impairment? This includes property, plant and equipment as well as intangible assets, such as goodwill, and investments
- Are fair value calculations affected? This includes defined benefit pension actuarial assumptions, share option values and the value of investment property portfolios.
- Are loss provisions required as part of contract accounting?
- Are there implications on capital and reserves? In particular, this might concern dividends and their legality,
- Are assets recognised on the balance sheet recoverable? This will include appraisal of deferred tax asset recoverability.

For accounting estimates that give rise to significant risks, the auditor is required to evaluate how management have considered alternative assumptions or outcomes (of which there may be many), and why it has rejected them, or how management have otherwise addressed measurement uncertainty in making the accounting estimate.

Where assets are re-measured by the client then the use of sensitivity analysis will be key in relation to the audit work. Auditors must ensure that all relevant potential scenarios have been considered.

ISA 560 (Subsequent Events)

Auditors may need to consider multiple outcomes ensure that all potential scenarios are considered. Changes between the balance sheet date and the date of signing the accounts (and then to the date of the audit report) will need to be factored in.

Auditors should remind clients to ensure that they incorporate a comprehensive post balance sheet events review up to the date of signing the accounts. Where events arise, the auditor will need to identify whether they are adjusting or non-adjusting events and ensure the necessary disclosures required by the financial reporting framework is applied. This would normally be evidenced on separate documentation that supplements conclusions drawn on subsequent events forms (eg. A41) completed as part of the engagement.

Documentation

Documentation in these areas will be critical over the coming months. Firms will need to keep on top of their client-specific as well as macro-level understanding to ensure audit reflect risks brought into play by Brexit.