Governance *in brief*

The vote to leave – key considerations for half year reporting

Headlines

- There is an immediate need to consider implications for your business and activate contingency planning. There is a premium on good communications to your people and the stakeholders outside your organisation.
- Forward looking indicators in your business (such as forward bookings, contact conversion rates, supplier forward pricing) will be useful barometers for internal planning.
- For half-yearly reporting, almost upon us, there is an immediate need to assess whether there are any accounting and reporting matters to address – consider risk and uncertainty disclosures, financial risk disclosures, liquidity issues and asset impairment indicators. In addition, any forward-looking commentary should be considered carefully during this period of heightened uncertainty.
- In the lead up to the 2016 annual reporting season, audit committees will need to consider the broader implications across all aspects of their remit.

The result is in

After several months of intense debate the British public has spoken and made clear that it sees the UK's interests best served by leaving the European Union (EU). The UK must now forge a prosperous future outside the EU. In doing so we must draw on great strengths. The UK is in the top tier of the world's most competitive economies. We have strong institutions and a highly skilled workforce. Our success in attracting inward investment confirms that the UK is a great place to start and grow a business. The fact that UK employment is at record levels testifies to the resilience of our economy in a slower growth world.

However, it will take some time for the full implications to become visible and whether the British vote has knock on effects elsewhere, so businesses will have to remain vigilant and consider their resilience in their forward planning and risk management.

The immediate business impacts
At Deloitte, we recently engaged our leadership team to consider the implications of the EU referendum on our clients. We focused on the likely impacts in the run up to the referendum vote and in the immediate aftermath if there was a vote to leave. Participants identified five major channels through which organisations could be affected:

1. Reduced availability and higher cost of capital: Short term market liquidity fears have prompted HM Treasury and the Bank of England to make available £250 bn of additional liquidity. However, it would be wise to review your financing needs over the short and medium term, review the terms of facilities and consider the impact of any plans to raise or refinance debt. Considerations should include whether your facilities include Brexit clauses and, if so, what contingency plans are in place.

2. Sterling depreciation: Whilst the costs of hedging have risen, if you are dependent on imports, you will likely now be reviewing your hedging strategy in light of the depreciation in the value of sterling on costs. If you are a significant exporter, you will be considering how you might quickly exploit this boost to competitiveness? It is also worth considering any impacts on dividend flows to the holding company that might influence the group's ability to pay a dividend.

3. A sell-off in equities and capital outflows: Higher uncertainty would tend to fuel capital outflows and depress the value of UK denominated assets; this may create a gap in funding for some projects and weaken demand for some asset classes. Have you reviewed major projects and M&A activity? A reduction in sterling combined with low interest rates may also make UK assets attractive to opportunistic foreign buyers.

4. Fall in business confidence: Over the last 8 years our CFO survey has shown that sharply lower business confidence and risk appetite is associated with weaker capital spending, M&A and hiring. Whilst economists will be reviewing their forecasts, it would be wise to consider how you would react to a more risk averse business environment and potentially reduced spending by other corporates? In other words, have you a defined set of contingency plans?

5. A premium on communications: Organisations which are likely, or perceived, to be most impacted by the leave vote will need to communicate in a timely and effective fashion with investors, employees and customers. Other organisations may wish to reassure stakeholders that the effect on them is limited. After the initial wave, all stakeholders will wish to have regular updates as the situation evolves and effective communicators will normally be admired. Do you have a clear communication plan?

Given the numerous uncertainties we believe that the focus in terms of contingency planning should be on minimising short-term risks at minimal cost.

Navigating uncertainty – key considerations for audit committees
For corporates, this is the beginning of a period of heightened uncertainty. While most of the major implications will only become clear with time, businesses need to be considering how they might be affected by Brexit and the uncertainties in the period leading up to it, however long that might be. For audit committees there will be a number of matters to consider arising from the vote which impact their areas of responsibility.

Corporate reporting – implications for half yearly and annual reports
The half year reporting season is shortly to be upon us, and this half year will be scrutinised for messages about the possible impact on UK listed companies.

Directors will be considering the following:

- Principal risks and uncertainties– what is the impact on the company's principal risks and how they are being managed? As you will be aware, only a handful of companies included Brexit as a risk in their annual report and now we would expect virtually all companies to do so. Such disclosure could include new risks that need to be disclosed or changes to the potential impact or likelihood and mitigating activity for existing risks. For the half-yearly report, disclosure may need to include more detail than the usual approach of summarising and referring to the last annual report.

- Critical accounting judgments and areas of estimation uncertainty – should the discussion of the judgments and estimates to be disclosed under IAS 1 change, or should new items be added to that discussion? For the half yearly report, consider the requirements to provide an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Sterling depreciation will likely affect many end of June balance sheets.

- Volatility – is short term or longer term volatility likely to impact the key assumptions used when developing forecasts, and which judgments and disclosures could this affect? In particular, it is worth considering asset valuations, pension assumptions, financial instruments and foreign exchange impacts, especially for valuations as at 30 June 2016. Are valuations impacted by market liquidity issues?

- Impairment reviews – directors will have to form a view as to whether they believe the market reaction to Brexit is a trigger event for impairment reviews.

- Longer term viability – will any effect on principal risks or volatility considerations lead to an impact on the company's longer term viability statement? In the second half of the year most companies will now be embarking on their three year planning cycle prior to budget approvals in Q4. Do directors wish to give special guidance to management at this stage? Do directors believe that they should be refreshing the analysis underlying that statement at this stage?

- Disclosure – we expect extensive disclosures about the considerations and management action arising from Brexit in half year annual reports, largely in the front half commentary, to provide investors and other stakeholders with a view on the potential impact and what management action is being undertaken.

External audit considerations for audit committees
The trend has been for external audit plans to be presented earlier in the year than previously. We would expect the July audit committee to include a discussion of the audit risks arising from Brexit and the impact on both the external and internal audit plans:

- Internal audit scope – should the scope of internal audit now include any contingency planning, or testing the robustness of key risk indicators which provide early warning/horizon scanning intelligence?

- Significant risks – is the audit committee satisfied that the auditors have identified all the significant risks in light of this event, and have they considered whether the changes to the political and economic environment impact risk classifications and are the planned responses to risks still appropriate?

- Specialists – where the audit involves the use of specialists, in particular financial instrument, pension and valuation specialists, is there a need to discuss with them and/or revisit the scope or timing of their work?

Status of EU reporting and audit requirements
Any changes to reporting requirements will become clear in due course depending on the timescales set for agreeing the terms of leaving the EU – however, in the short term:

- EU regulations and EU-inspired UK laws will continue to apply for at least two years – meaning consideration of laws and regulations relevant to the short term will be unchanged;

- there will be no impact on implementation of EU audit reform changes, which came into effect for periods commencing on or after 17 June this year as these are enshrined in UK law; and

- for the foreseeable future, the requirements for use of IFRSs as endorsed for use in the European Union (including the need for endorsement of new standards before they can be applied) will not change.

Direct and indirect tax implications
Likewise, in the short term, the vote to leave the EU will have little, if any, immediate impact on the approach to or structure of indirect or direct taxes. The UK remains an EU Member State until a secession agreement has been concluded. Few changes are likely to occur while the secession negotiations take place and the scope of future tax changes would be determined by the outcome of those negotiations. The Chancellor has indicated that an autumn budget will consider the impact on the government's finances which will include taxation.

Following secession it is possible that the UK's approach to taxation could diverge from the current position, as future governments could have additional freedom of choice. Some of the possible models for post-EU arrangements would include continued adherence to the EU's direct tax obligations, though.

Some indirect taxes are EU taxes: principally VAT and customs duty. The UK would need to introduce its own customs duty system, although some models would allow the UK to remain in Customs Union with the EEA and EU states. VAT is already a part of UK law and would continue without the VAT Directive, subject to future changes and new legislation for some minor points. Importantly, going forward decisions of the Court of Justice of the European Union would no longer impact UK VAT rules.

Even without EU legal constraints, the UK is unlikely to develop wholly new tax systems. The EU direct tax restrictions are relatively minor and the focus on a territorial system of corporate tax is a model adopted by many other countries. Similarly, there is a worldwide focus on VAT systems and many emerging economies are introducing VAT. In that context, it would surely be surprising if future governments were to make fundamental systems-wide changes. Nonetheless, some models will give that flexibility to future governments. More minor changes could be made more easily, of course.

Deloitte View

- Businesses now need to ensure that they are set up to navigate the immediate risks and impacts of an exit, and have the processes and people in place to manage a period of uncertainty.
- The half year reporting season is upon us and management will wish to present boards with analysis of the potential impact on their business and actions being undertaken to underpin statements to the market
- For many businesses, this could also bring opportunity and planning should also focus on identifying and exploiting these.

Further information
Please go to our **www.deloitte.co.uk/eu-referendum**

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For further details about the Deloitte Academy including membership, please email **enquiries@deloitteacademy.co.uk**.

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