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Audit committee spotlight: Is your organization prepared for Brexit?

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8 areas for audit committees to discuss with management

The recent Brexit vote has created significant uncertainty for U.S. entities with ties to the UK and the European Union (EU). Whether an organization has British or EU customers or operations, a range of potential questions and risks come to mind. Audit committees should seek reassurance that their organization is prepared for this shake-up in the business environment. Does management fully understand how the vote to leave the EU will affect the organization (e.g., regulatory effects, buffers against risks and potential costs)? Is the organization prepared for what may happen in the future?

The following are some broad concerns an audit committee should share with management in light of Brexit.

1. **Does management have a strategic plan to manage risks and lessen negative effects?** How is it going to execute that plan? Has the organization done a thorough Brexit risk assessment? To what extent has the company hedged against currency risks and its foreign exchange exposure?

What does Brexit mean for those hedges, now and going forward? Should the company adjust its hedge strategies? If a company has not hedged in the past, should it consider hedging in the future — in light of the expected volatility in currencies and the resulting risks — or will it continue to absorb those risks? To what extent is the company exposed to debt denominated in pounds sterling? How will Brexit affect current or future hedging strategies associated with interest rate risks and/or currency risks?

2. **How will Brexit affect the carrying value of assets or business units exposed to the UK or EU?** Impairment evaluations of assets or business units with exposure to the UK or EU will need to consider the effect of the Brexit vote on June 30 financial statements.

- 3. Will the company see significant translation gains and losses in terms of functional currency?** Entities with UK subsidiaries whose functional currency has been pounds will be most affected by Brexit. Are foreign subsidiaries using the right functional currency? A lack of volatility or immateriality may have masked this issue in the past, yet current wild swings can raise the question. The functional currency of foreign-domiciled holding companies is often the functional currency of the parent company.
- 4. How will Brexit affect historical guidance?** What's the thinking on sales and purchases in these foreign markets, especially with the expected economic slowdown and the effects of the slowdown, particularly in the UK? How will Brexit affect customers and suppliers and the company's interactions with them?
- 5. What are the implications for communications?** How and what does the company plan to communicate to stakeholders? What has it put out pre-Brexit (i.e., earnings guidance to stakeholders) and what will it put out in the future? How and what will it communicate to customers and vendors? What does it plan to say to its staff, who might be directly affected in terms of hours, availability and immigration?

- 6. How will Brexit affect the company's financial statement?** For entities that have significant exposure, what should they expect to see in the June 30 quarter, and what might they see going forward?
- 7. What about added complexities?** What kind of complexities will be added to regulatory compliance and reporting requirements in the future, as the UK tussles with building a new regulatory framework apart from or emulating EU directives?
- 8. Are there benefits?** Another question to pose is whether there are benefits to Brexit. Those may come in the cost of borrowing. Many believe Brexit will result in the Federal Reserve's delaying any increase in interest rates. With that possibility, what is the financing strategy going forward?

Audit committees should exercise their governance responsibility to ensure management is adequately addressing the aftereffects of Brexit. While no one is certain of the eventual outcome, organizations would be wise to take a hard look at challenges and risks, and prepare to meet them.

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