Chartered Institute of
Internal Auditors

Organisations' preparedness for Brexit:
an internal audit perspective

iia.org.uk/brexit

Foreword

'NOTHING IS AGREED UNTIL EVERYTHING IS AGREED'

More than two years after the Brexit referendum, the UK will be leaving the European Union on 29 March 2019. Due to its complicated nature, Brexit has the potential to be a major disruptor to business as more than 40 years of EU-wide market integration is overturned.

The impact has the potential to affect businesses significantly; and future arrangements for regulation and cross-border trade post-Brexit are high on many corporate agendas. Organisations should assess these risks and investigate different options to mitigate them. This is where internal audit can provide independent assurance on the organisation's Brexit preparedness.

The case studies, which form the core of this report, feature six companies from a variety of sectors who have shared with us how their organisations have prepared for Brexit and provide some examples of best practice. Some have opened new subsidiaries in other European countries to ensure they are able to serve their customers post-Brexit; others are looking into sourcing alternative suppliers; while some are assessing what this means for their EU-born workforce.

In addition, we also surveyed heads of internal audit in the UK and asked them what active steps their organisations have taken to prepare and what the role of their internal audit function has been.

The report shows us that although many organisations have prepared adequately for Brexit, over one-third of the surveyed organisations do not appear to be as prepared as they should be. However, it is not too late.

We encourage internal auditors to continue in their efforts to enhance the role of internal audit in their organisation's Brexit preparations, and we hope that this report will help them on that path.

Dr Ian Peters MBE
Chief Executive

KEY FINDINGS

- A vast majority (82%) of the organisations surveyed are affected by the risks associated with Brexit.
- The top three risk areas affected by Brexit are: regulatory change (69%), recruitment of skilled and unskilled labour (61%), and supply chain management (57%).
- More than half (53%) of organisations have undertaken scenario planning, which has included assessing the issues that will impact their organisation the most, i.e. regulatory change (56%), access to skilled and unskilled labour (52%), and volatility on the currency markets (46%).
- The main difficulties cited by organisations undertaking scenario planning are lack of clarity from government on its preferred Brexit deal (79%), the number of potential scenarios (68%), and the lack of information available (55%).
- Three-quarters (75%) of the surveyed organisations have established an internal Brexit steering or working group to coordinate the potential impact of Brexit and the response the organisation is taking; in almost half (47%) of the steering groups, internal audit has a seat at the table.
- Almost half (40%) of the surveyed organisations say they have not received an appropriate level of engagement and information from government in preparing for Brexit.

Of the organisations surveyed:

82% are affected by the risks associated with Brexit

53% have undertaken scenario planning

75% have established an internal Brexit steering or working group

40% say they have not received an appropriate level of government support

ABOUT THE SURVEY

From 13 September to 13 October 2018 we conducted a survey of Chief Audit Executives across the UK to understand their reactions and responses to Brexit. This report is based on the responses of 95 cross-industry Chief Audit Executives. Most (80%) are from the private sector and are based in England (89%). The survey asked questions on topics such as risks, whether or not the organisation has undertaken scenario planning, and their thoughts on the level of government support when helping them prepare their organisation for Brexit.

INTRODUCTION

With the UK committed to leaving the European Union in March 2019, organisations need to ensure they understand how their business will be impacted and put plans in place to manage or mitigate this where necessary. With political negotiations continuing and little clarity to date as to what the UK-EU relationship will look like post-March 2019, organisations are reviewing workforce strategies, re-engineering supply chains and preparing for regulatory change.

The Chartered Institute of Internal Auditors (Chartered IIA) has attempted to provide an overview of organisations' preparedness for Brexit, the practicalities of undertaking scenario planning, the key risks associated with Brexit, sharing lessons learnt, and the role of internal audit in assisting the organisation to prepare for this potentially disruptive event.

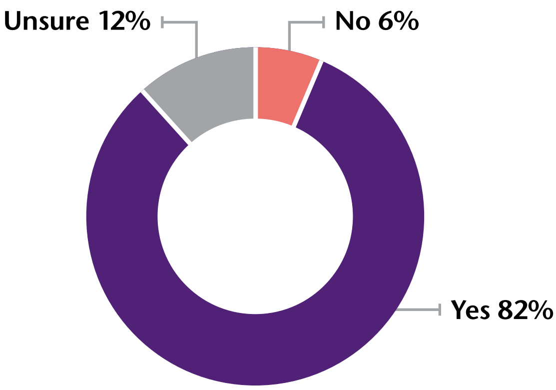
The Chartered IIA is committed to share what best practice looks like so that others, in turn, can feel confident in the advice given to their board and audit committee.

Almost 100 Chief Audit Executives participated in this research, providing us with detailed insight into their organisations' readiness for Brexit. In addition, we also conducted six in-depth case studies through interviews to benchmark and provide a comparative perspective. We would like to thank Centrica, Johnson Matthey, and Standard Chartered for their contribution and the three other organisations that wished to remain anonymous due to the politically and commercially sensitive nature of Brexit.

Key findings

Brexit has the potential to be the most disruptive event to UK businesses in decades. Companies are reassessing their investments amid the ongoing uncertainty and there are few businesses that will be unaffected. Indeed, in our quantitative survey, 82% of our respondents anticipate that their organisation will be affected by the risks associated with Brexit.

Fig. 1 *Does your organisation anticipate being affected by the risks associated with Brexit?*



RISKS

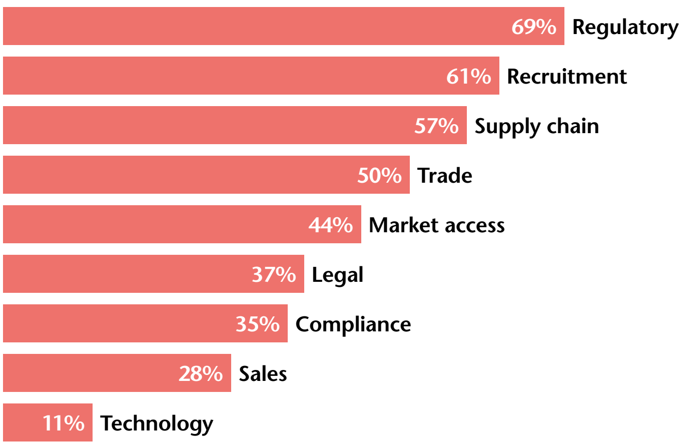
One month after the 2016 referendum, the Chartered IIA undertook a Brexit survey to assess the key risks organisations were facing. The 2016 survey revealed that the top three risks of highest concern to Chief Audit Executives were volatility on the currency markets (69%), regulatory change (55%), and falling consumer and business confidence (47%).

Two years on, in our 2018 survey over two-thirds (69%) of organisations say their biggest risk is regulatory change. This is a particular concern for financial services organisations that have begun to prepare to relocate certain activities to other EU countries to enable business to continue and to service their customers regardless of the outcome of the negotiations. Much UK regulation is derived from EU legislation and Brexit will inevitably have an impact on future regulatory and legislative requirements.

Access to skilled and unskilled labour (61%) was the second biggest risk identified. This issue was also mentioned frequently in our case studies as it poses challenges to the recruitment and retention of skilled and unskilled EU-born staff. Most organisations have identified the individuals impacted by potential restrictions to free movement of labour and sought to provide them with reassurance on their future right to stay and increased communications to them on issues such as employment law and immigration policy.

The third most cited risk was supply chain issues (57%). As many organisations have established strong supply chain links with European businesses, a potential no-deal Brexit will mean that frictionless trade would come to an abrupt halt and the UK would immediately revert to World Trade Organization terms. It would see the application of import tariffs and businesses would experience a sharp spike in mandatory administrative requirements.

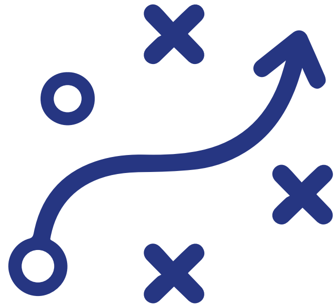
Fig. 2 *What are some of the existing risk areas affected by Brexit? (please select all that apply)*



Identifying the risks that Brexit brings for organisations will involve an assessment of the impact of custom duties and tariffs, supply chain disruption, labour shortages, and restrictions on transfers of customer data.

It is important that internal audit works with the organisation to ensure that boards and audit committees understand the potential risks associated with Brexit and their severity. It should ensure that risks are identified, that mitigating actions are put in place and outcomes monitored. It should also call out if the organisation is not doing enough to mitigate the Brexit risk.

SCENARIO PLANNING



Two options that have been considered since the Brexit referendum is whether there is a no-deal Brexit, or whether the UK manages to leave the EU with a negotiated deal, with the latter being viewed as less disruptive.

The prospect of a no-deal Brexit is a realistic one and organisations have no other option but to prepare for this outcome. By undertaking scenario planning organisations are able to define their critical uncertainties and develop plausible scenarios in order to stress test the impacts and the possible responses for each scenario.

For publicly-listed companies, a failure to scenario plan is not an option. Listed companies are required under company law to report any material risks to their shareholders. Businesses undertaking comprehensive structured scenario planning will be able to provide assurance to their shareholders as to their readiness for any potential Brexit changes.

With just months to go until the final leaving date, our research indicates that a majority (53%) of organisations have undertaken scenario planning. Worryingly though, a remarkable 37% of respondents say they haven't undertaken any form of scenario planning.

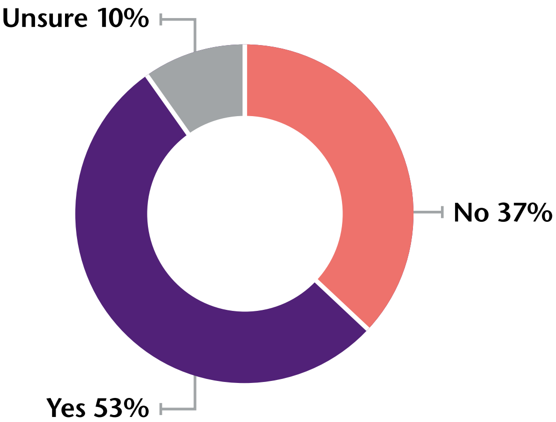


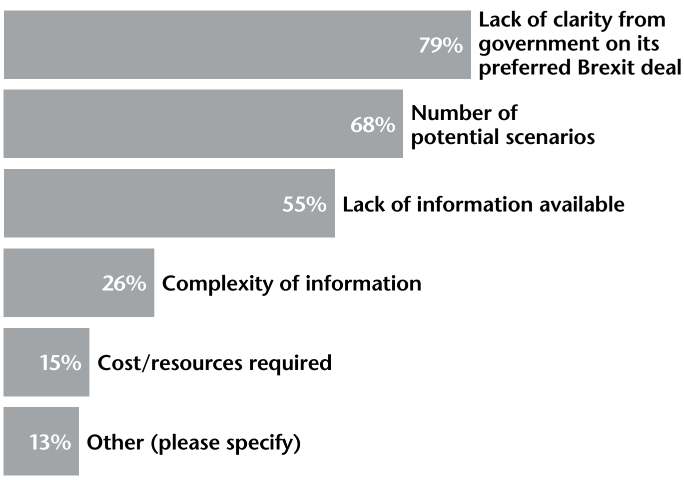
Fig. 3 *Has your organisation undertaken Brexit scenario planning?*

The case study organisations considered several scenarios but the most time and resources was spent focussing on a no-deal Brexit as this would be the most disruptive. This scenario has already led several financial services firms to relocate some of their operations to EU countries, including recruiting an internal audit function in these countries to comply with local regulations; while other businesses will need to source new suppliers; and potentially increase their prices. To the question of whether they had assessed the implications of a no-deal Brexit, just over half of respondents (51%) say they have, with more than a third (38%) saying they have not.

When asked whether their organisation assessed the implications of the Chequers agreement, the government's preferred deal, almost half (42%) of our respondents say they have not, with only 29% saying they have.

Businesses are finding Brexit scenario planning difficult because great uncertainty still remains. The most significant challenge organisations cite is the lack of clarity from government on its preferred Brexit deal (79%). This is alongside 68% of organisations citing the number of potential scenarios as something they struggle with. This is followed by a lack of information available (55%) to inform their scenario planning exercises.

Fig. 4 *If your organisation has done scenario planning, what were the main difficulties faced? (select all that apply)*



The complexity of large businesses makes scenario planning perhaps more challenging than for their smaller counterparts but when we compare large organisations (1,001+ employees) to smaller sized organisations (up to 1,000 employees), only a quarter have not undertaken scenario planning while in the latter group, more than half (59%) have not. Larger organisations have the skills and resources to devote time to scenario planning whilst smaller organisations often don't have these skills, or are, perhaps, less exposed to the risks associated with Brexit.

If they haven't done so already, it is vital that organisations begin scenario planning as soon as possible, otherwise there is a risk of not meeting the expectations of boards and audit committees. Senior management and boards should work closely with internal audit to ensure that the organisation is best prepared for Brexit – whatever the outcome.

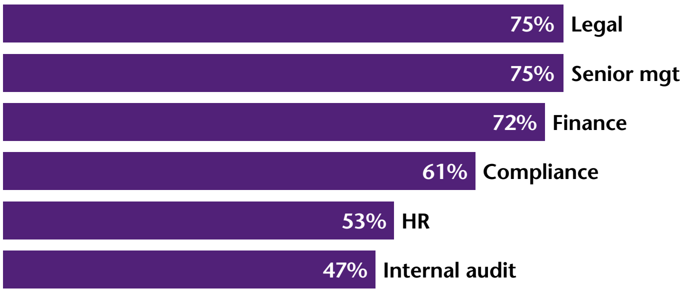
BREXIT STEERING COMMITTEE

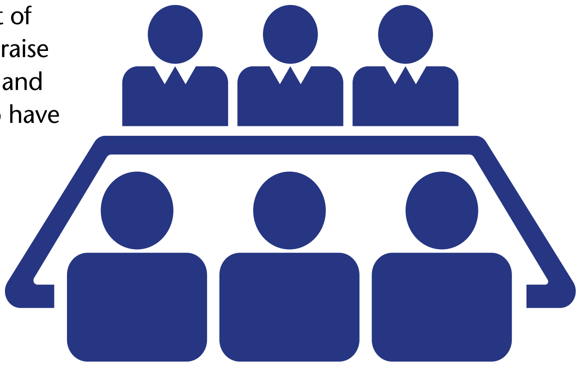
Dedicating both resource and time to prepare for the UK's departure from the EU is necessary for organisations to understand, assess, plan and implement actions to mitigate the risks associated with Brexit. Following the 2016 referendum, many organisations established internal Brexit steering committees to project manage preparations.

Our research shows that most (75%) organisations have established an internal Brexit steering committee, but a quarter (25%) have not. When we compare financial services firms and non-financial services firms, it is surprising that only 71% of financial services firms have set up a steering committee, whilst 80% of non-financial services firms have set up a forum to monitor Brexit developments.

According to the survey, the business functions that usually sit on these committees are: legal (75%), senior management (75%), finance (72%), compliance (61%), HR (53%) and internal audit (47%). Sitting on these committees allows internal audit to have oversight of key actions and responses but to also raise questions and challenge assumptions and findings. Most of our case studies also have a seat at the table.

***Fig. 5** Which business departments are involved in an internal Brexit steering committee on a regular basis? (select all that apply)*





75%

of organisations have established an internal Brexit steering committee

71%

of financial services firms have set up a steering committee

47%

of respondents say internal audit has a seat on the internal Brexit steering committee

GOVERNMENT SUPPORT

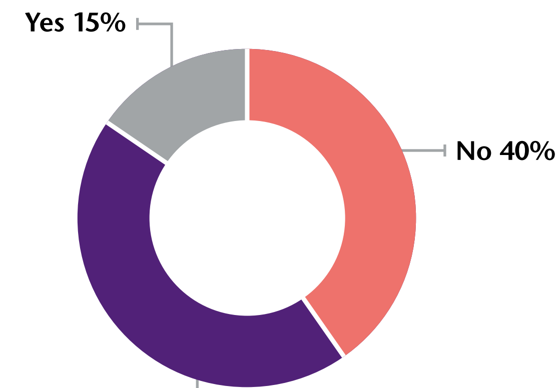
Despite government having published a raft of technical notices providing guidance to businesses of what to expect in a no-deal outcome, 40% of our survey respondents say that their organisation has not received sufficient support and engagement from government to prepare for Brexit.

Only 15% of respondents believe their organisations have received enough support but a remaining 45% were unsure. To explain the high latter percentage, internal audit functions might not have been aware of conversations between their organisation and government. Internal audit, however, can and should establish if these conversations are taking place. In many instances these dialogues are led by government affairs and policy teams and/or the board.

As mentioned earlier in this report, organisations found it difficult to undertake scenario planning due to the lack and complexity of information on the government's preferred Brexit deal and the number of scenarios in play. Many sectors waited many months for the government to publish future partnership papers laying out the UK's view, such as the Chequers agreement.

Most of our case studies, on the contrary, have been in active dialogue with government or have consulted with ministerial departments and regulators, where appropriate, to better understand the potential impacts of the various options being considered. These organisations possess particular knowledge on areas such as non-tariff barriers, financial products, and trading with third party countries and as such government established relationships with them to understand the practical effects of Brexit on, for example, changes in supply chain, financial services infrastructure, and on wider business operations.

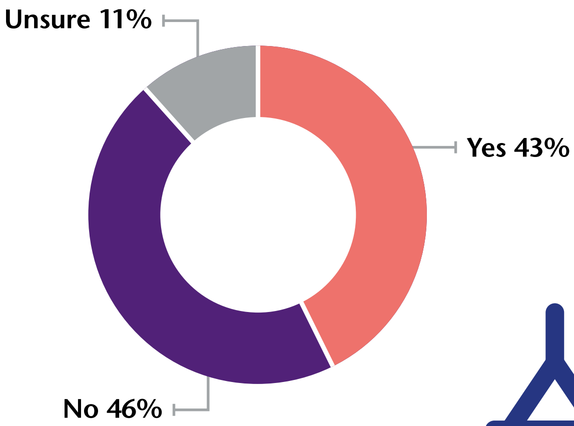
Fig. 6 *Has your organisation received an appropriate level of engagement and information from government to assist you in preparing for Brexit?*



As companies weigh up the risks of investing in scenarios that may not crystallise, companies continue to look to government and regulators to provide support to help navigate them through the complexity.

When asked if our financial services respondents were prompted by their regulator to undertake a Brexit readiness assessment, almost half (46%) of the firms said they were not while 43% were requested by the Prudential Regulation Authority and the Financial Conduct Authority to undertake one.

Fig.7 *Has your regulator prompted you to undertake a Brexit readiness assessment? (financial services respondents)*



Only **15%**
have received an appropriate level of engagement and information from government to assist in preparing for Brexit

Key lessons for internal audit

- Internal audit should ensure their risk assessment and audit planning processes are dynamic and agile enough to react to the latest developments. Agile auditing is a relevant and appropriate methodology for when the end goal is still being refined but you need to get started. It also requires short sprints of assurance which could suit the pace of Brexit change.
- Organisations should prepare for all scenarios so any problems associated with Brexit are addressed in a timely fashion.
- If a dedicated Brexit steering committee exists within your organisation, internal audit should have a seat at the table to observe the discussions and decisions made on these committees; thereby enabling them to raise any concerns before decisions are implemented.
- If the organisation has not undertaken scenario planning, internal audit should raise this with its board and audit committee to ensure adequate time and resources are invested in identifying what the organisation's post-Brexit future looks like. It is not too late!
- With only months to go until 29 March 2019, now is the time for businesses to assess the impact of this major change on their business operations, for example, what are the risks, what mitigating actions need to be put in place and ultimately what is the impact on the future of the business?
- Consider contingency plans for those areas of greatest impact for a business in the likelihood of a worst-case outcome.
- Internal audit may consider undertaking further tangible work pre- and post-Brexit as it sees the need arising via its continuous monitoring. Internal audit needs to be cognisant to minimise any internal audit impact on the project when it reaches critical milestones.
- Brexit is a polarising issue so internal auditors need to be mindful of their own and others' unconscious bias when discussing issues or providing assurance.
- Internal audit is expected by the board and audit committee to provide assurance as to risk management, internal control and governance. Brexit is no different. Internal audit should provide an assurance to the board and audit committee as to whether the organisation is prepared for Brexit and whether the organisation has fully explored all scenarios.
- If internal audit does not have the appropriate skill set to provide the assurance sought, then they need to look to other assurance providers, e.g. external co-sourced third parties.
- Consider what the impacts of Brexit will be on your internal audit function both now and post-Brexit. Is it taking time away from other risk priorities? Do you require an increase in your internal audit budget?

CONCLUSION

With only months left until the UK is set to leave the EU, there is still a lot that businesses will need to do to help them steer through the potentially disruptive events ahead. This research has given a snapshot, from an internal audit perspective, of organisations' preparedness for Brexit, the key risks they are facing, what the future might look like and the role of their internal audit function.

Through our case studies we got a closer look at the practicalities that are involved in preparing for Brexit and the key challenges that internal audit functions face during a time of ongoing uncertainty. These six internal audit functions are all engaged in providing advice and insight into the risk and control issues relating to Brexit. In our 2016 survey, Brexit was not on internal audit's radar, given the general feeling that a remain vote would prevail. At the time, Chief Audit Executives were mostly concerned with volatility on the currency markets, regulatory change, and falling consumer and business confidence. A little over two years later, access to skilled and unskilled labour has shot up the risk register.

Internal audit is best placed to provide independent and objective assurance on organisations' Brexit preparedness, but in order to do that it should take a proactive role by stating its view on the extent to which senior management, and the board, have considered key risks and how well current or new controls address those risks.

Internal auditors play a key role in supporting organisations to design and implement strategies to navigate Brexit risks. What the post-Brexit environment will look like is still unclear; but, as organisations form their projects and plans, internal auditors will need to develop a robust audit response to give boards and audit committees the assurance they need.

It is important that internal audit is well informed to be able to have constructive dialogue with the business. The relationships internal audit have built over time with different business functions across the organisation will now be increasingly important. Internal audit will also need to collaborate with key business functions, e.g. risk, HR, compliance and in particular the first and second lines of defence to map responsibility and accountability for the provision of assurance to board, audit committee and senior stakeholders.

Internal audit's advisory or consultancy and assurance role will be highly valued in the months to come.

Case studies

Johnson Matthey

Angela O'Hara, Group Assurance and Risk Director

Johnson Matthey is a leading multinational speciality chemicals and sustainable technologies company with 14,000 employees globally, operating in more than 30 locations.

Immediately after the referendum, Johnson Matthey set up a Brexit working group to give careful consideration as to how best to navigate through the situation. The working group, headed up by a Sector Chief Executive, has 9 functional work streams, each of which is led by a nominated leader who can co-opt people on the streams if functional expertise is required. The 9 streams are: indirect tax, supply chain, regulatory, people and talent, commercial, legal, trade and controls, research development and innovation, and communications.

A dedicated project manager was appointed to assist the Sector Chief Executive to project manage the work streams and who reports their individual progress, as well as the overall progress of the working group, to senior management. Several of the streams work together on issues of common interest. One such collaboration is that between the indirect tax and supply chain streams working together on Johnson Matthey's response to issues around border controls, tariffs and non-tariffs issues.

Internal audit

Due to a lack of certainty on future trading arrangements with the EU, the internal audit department has not been directly involved in the individual work streams as all streams report their activities in a transparent manner up and through the Brexit project team, Group Management Committee and the board. The audit function placed reliance on the work of the company's Head of Risk, as well as the Group Assurance and Risk Director's desk top review, while allocating the function's narrow resources on other high risk areas.

Although the Group Assurance and Risk Director's role covers both risk and audit, the focus has been on understanding how the risks were assessed, the governance associated with this risk assessment and the mitigating controls being put in place.

The audit team is developing a readiness assessment to evaluate the organisation's overall preparedness and that of the individual work streams. In addition, the assessment will determine the level of resources required so the business is fully prepared in the event of a no-deal Brexit.

Scenario planning

The impact of Brexit has been limited but one area that has been of particular concern is that over the rights of their EU workers. The chemicals and sustainable technologies industry needs a large number of skilled and diverse workforce. Johnson Matthey employees several hundred EU nationals and their HR department have increased their communications to these employees on issues such as employment law and immigration policy in case of a transitional Brexit - when employees can apply for Settled Status. Johnson Matthey is awaiting further guidance from the UK government on the rights of EU nationals in the eventuality of a hard Brexit before further assessment is undertaken.

The company is considering a range of possible exit scenarios, each coming with possible implications for the business, and as a publicly listed company, Johnson Matthey is required under company law to report material risks to its shareholders. The financial costs of scenario planning are small compared to the consequences of a hard Brexit.

The Brexit working group's remit is to look at both a transitional arrangement deal and a hard Brexit but the team decided early on that it would focus on the latter scenario and look to mitigate those risks as having the biggest impact to the organisation. The team also considered a possible transitional arrangement but does not expect this to have any impact until its implementation on 1 January 2021.

Identification of the risks that Brexit brings for the company will involve an assessment of the impact of custom duties and non-tariff barriers, as well as supply chain disruption; three areas the company is focussing on strongly in case of a hard Brexit. It sought to mitigate these risks by looking at World Trade Organization (WTO) rules around tariffs and by engaging with suppliers early on to look at appropriate stock holding. Other work streams, for example, are considering the possible effects on the organisation's contractual obligations, and access to EU research and innovation funding through the EU's Horizon 2020 research and innovation programme and its successor, Horizon Europe.

While recognising smaller organisations simply do not have the resources to assess what the worst-case scenario would mean to their enterprises, Johnson Matthey sought expert advice from professional services firms on employment issues and model tariff duties.

Government support

While several business and trade organisations expressed concern over the level of engagement from government in assisting businesses in preparing for Brexit, Johnson Matthey is actively engaged with the UK government in understanding the potential impact of the various options being considered. It has sought to create a dialogue with government and has specifically targeted certain departments within the civil service to seek clarity on areas of mutual interest.

Johnson Matthey has expertise knowledge of rules of origin of material and movement of goods across borders and the UK government has sought their advice on these issues to get a clearer understanding of their current practicalities and the effects a hard Brexit would have.

Advice

The internal audit function's strategy on Brexit and its associated risk are communicated to the audit committee as part of their detailed coverage of the audit plan. It also provides assurance to the audit committee on the organisation's preparations for Brexit. To achieve this, the right level of buy-in is required from senior management and the board, as well as acquiring expert advice from key stakeholders and a high level of engagement from government to get a better understanding what the organisation needs to do in case of a hard Brexit.

The internal audit function placed reliance on the information received through the company's risk management process, while not placing too much reliance on audits. The function makes sure their risk assessment and audit planning process are dynamic and agile enough to react to the latest developments and advises other organisations to prepare for all scenarios, so any problems associated with Brexit are timely addressed.

Centrica

Carolyn Clarke, Group Head of Audit, Risk and Control

Centrica provides energy and services to over 25 million customer accounts mainly in the UK, Ireland and North America through brands including British Gas, Direct Energy and Bord Gáis Energy.

The UK's decision to exit the European Union presents a number of risks, particularly in the event that Brexit takes place on 29 March 2019 without an agreed UK/EU deal. The main potential impacts of Brexit for Centrica include the following:

- the impact of macroeconomic factors (a weaker GBP, lower UK interest rates) which are likely to be felt if there is no Brexit deal);
- the loss off efficient cross-border electricity trading arrangements;
- uncertainty around GB carbon pricing policy if/when the UK leaves the EU Emissions Trading Scheme;
- a range of potential impacts on energy trading if the UK is no longer recognised under EU financial services and energy trading legislation;
- in a no-deal Brexit scenario, a risk that the Single Electricity Market (SEM) will not be maintained across the island of Ireland;
- a need for the Euratom Supply Agency to re-approve nuclear supply contracts (e.g. fuel supplies) from the EU to the UK, given the UK intention to terminate its membership of Euratom and create a new independent nuclear safeguards regime;
- the imposition of WTO import tariffs and the risk of logistical delays at border due to new customs clearance procedures, should the UK leave the EU without agreeing to develop (at least) a free trade deal; and
- a loss of 'blanket' data adequacy recognition covering transfers of personal data from the EU/EEA to the UK.

In addition, potential changes to the UK's immigration policy post-Brexit and the resulting loss of freedom of movement could constrain Centrica's ability to effectively source specialist workers, potentially leading to a shortage of skilled workers to satisfy demand.

Looking to the longer term, Brexit also presents risks concerning changing UK policies in relation to the energy market and carbon emissions in a post-Brexit environment, as well as the loss of UK influence over EU policies which will continue to impact the UK energy sector, directly or indirectly. These issues will also need close attention, but they are not the main focus of Centrica's short-term contingency planning.

Brexit project group

Shortly after the EU referendum, Centrica established an internal Brexit project group to investigate and assess the concerns raised by Brexit which could impact the Group and its customers. The project group is headed by the Corporate Affairs function. Other departments involved include the business units dealing with nuclear energy, energy trading, Centrica's Irish assets, customer facing businesses, Group Strategy, HR and the legal, regulatory and compliance teams.

Group Internal Audit remains independent to be able to provide objective assurance and advice. This offers GIA oversight of key events and allows them to raise questions and challenge assumptions and call out findings and observations.

Scenario planning

Two potential outcomes of the Brexit referendum are whether the UK should embark on a hard Brexit or soft Brexit. Currently the former scenario is being actively discussed within Centrica. Its priority is to continue to deliver its core operations by delivering the best price for its customers and ensuring it can still meet customer needs if a no-deal Brexit makes importing from the EU more difficult and expensive. It is considering the practical implications on its operations of all potential scenarios.

Internal audit view of risk and approach

The Head of Internal Audit doesn't view Brexit as a stand-alone risk, but sees it as a factor that increases the probability and/or impact of a range of risks arising. This includes skills access and its ability to trade efficiently with counterparties and continue to serve its customers in the UK and Ireland. The audit function is balancing these risks in the same way as any other risk affecting Centrica's operational effectiveness. The focus is on ensuring that there are adequate contingency plans in place to respond to all eventualities as traditional control mitigation auditing is challenging due to the lack of certainty around a future UK/EU relationship. GIA will be continually reviewing the effectiveness of the mitigation measures that are in place as the deadline approaches.

Advice for other functions

It is tempting to view Brexit as an overwhelming problem for an organisation, but the Head of GIA advises other internal audit functions to treat Brexit in the same way as any other external factor creating risk for the organisation. It is important to focus on the specific issues and risks that occur as a result of ongoing uncertainty. She stresses the importance of prioritising and identifying the consequences for individual organisations, considering contingency plans for those areas of greatest impact for a business in the likelihood of a worst-case outcome.

Contingency plans to mitigate the risks associated with Brexit must be at an acceptable level for the business. Internal audit needs to retain its independence and focus on those risks that are of most importance to the organisation, strategically and operationally, as opposed to those risk areas receiving a high level of press coverage. This is what the Board and Audit Committee will seek assurance over and will value.

Standard Chartered

Andrew Pring, Head of Audit – Europe and HR, Legal, GCS, CA & B&M

Standard Chartered is a British multinational banking and financial services company and employs more than 86,000 people around the world. They are listed on the London and Hong Kong Stock Exchanges as well as the Bombay and National Stock Exchanges in India.

On a macro level Brexit has had no material impact to date but the London-headquartered bank has prepared itself for a potential no-deal outcome by reviewing its legal structure within the Euro zone, and is in the process of acquiring the necessary licenses.

It chose to set up a new European subsidiary in Frankfurt, where the bank already has an established presence from which it services a range of clients and conducts its euro clearing activities. Like many other financial institutions, by setting up a European subsidiary it enables the bank to continue trading with its existing counterparties that would be impacted by the loss of EU passporting rights. This way it is able to serve its clients and protect its revenue while remaining UK domiciled. It is currently awaiting approval from German and European banking regulators for the hub, which will allow it to continue operating across the EU after the UK leaves the EU in March 2019.

The uncertainties linked to the ongoing Brexit negotiations, coupled with larger geo-political events such as trade tensions between the United States and China, and ongoing concerns over emerging markets, have the potential to delay corporate investment decisions.

Germany

The European Central Bank (ECB) plays a key role in setting the conditions for banks' new EU bases. To ensure they have a long-term plan for their post-Brexit hubs, the ECB has requested Standard Chartered to submit additional information to ensure its Frankfurt office is a genuine stand-alone business that is able to service its German and wider European clients. To comply with local regulatory rules and expectations, the bank is now required to have appropriately sized second and third line functions, including a German-based risk management function and internal audit function.

To that end the bank has recruited a Head of Internal Audit who is familiar with German regulatory demands to oversee the bank's provision of internal audit services to its new entity. In Germany, financial institutions are required by law to audit everything on a three-yearly audit cycle whereas in the UK a more risk-based approach is the norm. A German banking license means that the bank is now bound by national rules and is required to operate to standards that the local regulator expects.

Scenario planning

Standard Chartered considered and tested all exit scenarios but focussed more time and resources on a hard Brexit scenario as it will be the most disruptive to the organisation. Immediately following the Brexit referendum the bank started preparations for a hard Brexit in the event the UK government and the EU fail to reach an agreement before 29 March 2019. If both sides reach an agreement by that time, a transitional arrangement will be put in place to help smooth the UK exit from the EU.

The ongoing uncertainty and resultant large number of underlying assumptions that are required to be made meant that scenario planning is challenging and requires regular review as certain assumptions prove to be incorrect and new or revised assumptions are required.

Brexit governance fora

An internal Brexit Steering Committee was set up after the referendum to assess and manage post-Brexit risks and the practical implications. Its primary focus has been on driving the direction of the Brexit preparations and making decisions on further progress and the appropriateness of the response the bank is taking.

In addition, a Brexit working group was set up which consists of numerous work streams. A project office was established which provides direction, coordinates and assists with resources and budgetary issues that may impact the work streams and manages the overall progress of the project. Due to ongoing developments around Brexit, the working group meets on a weekly basis. There are various work streams, Client Communications and Client Migration for example, look at the impact of Brexit on the bank's clients and, like all other work streams, submits its progress on delivering the necessary steps that ensure the bank is able to continue its activities post Brexit.

The bank's internal audit function attends all meetings of both groups to have oversight of key events and responses but to also raise questions and challenge assumptions and findings. Attending the meetings allows internal audit to continuously monitor the bank's response to Brexit.

As part of the internal audit risk based planning process, key projects will be considered for audit coverage. Given its significance and potential impact, the Brexit project was one selected for audit coverage in 2018. The audit was completed in August 2018.

Advice

To influence an organisation's response to Brexit, Standard Chartered's internal audit function advises other audit functions to attend their individual Brexit steering committee. By observing the discussions and the decisions made on these committees, internal audit is able to raise any issues before decisions are implemented. Internal audit found that it was able to deliver more value to the organisation by attending the various meetings, rather than intervening on an ad hoc basis or after the fact. It timed the abovementioned audit to be when matters were sufficiently advanced and crystallised but with time to respond before it reached the critical months prior to the March leaving date. The audit function may consider undertaking further tangible work pre- and post-Brexit as it sees the need arising via its continuous monitoring. The function is very cognisant to minimise any internal audit impact on the project when it reaches critical milestones.

Large UK financial services institution

Chief Audit Executive

As a large UK financial institution that also operates in the EU, the bank is ensuring that it can preserve access to EU markets for its customers and clients. To do so, it has chosen to expand the range of activity undertaken in an existing licensed EU subsidiary, taking advantage of and building on infrastructure and regulatory permissions already in place.

Should the UK's withdrawal from the EU result in a loss of relevant passports for the industry, this entity would be able to provide the bank's clients with access to European markets, including intra-EU payments, lending and deposit-taking.

The entity is in the process of extending its operational license to cover the bank's European activities. A new European Management Committee was set up to run this and to oversee a broad range of different products and services the Group offers across Europe. The organisation has sourced staff from across the Group to set up and support the European committee.

Implications for internal audit

Because the bank will be operating from another EU country, there are going to be direct consequences for the internal audit function. Currently the function audits its European locations from staff based in London with a small team based in the new hub, but it seeks to grow its European team and respond to the requirements of both local and European regulators. As such it has needed to provide clarity to the regulators on the future provision of internal audit services to its subsidiary. This has meant that the internal audit function has begun recruiting for roles and skill sets that are new to the location. It has been challenging to find senior staff who have the skill sets for future booked business but who are happy to join the company without a firm sense of exactly what business will be relocated.

For the wider organisation, changes were already made to people's personal contracts due to ring-fencing reforms being implemented in early 2018 to ensure they can continue to work for the appropriate entity post-Brexit. Ring-fencing of day-to-day banking services was one of the reforms brought in by the UK government to strengthen the financial system following the global financial crisis. To reassure its employees' concerns, the organisation issues regular updates on the bank's latest Brexit developments.

Scenario planning

Given the ongoing uncertainty as to whether a legally reliable transition period will be in place when the UK leaves the EU next March, the bank has been implementing its contingency planning so as to be sure of being able to continue to service EU-facing customers and clients in a seamless way, whatever the outcome. The bank continues to monitor political developments as the UK and EU look to negotiate a future economic relationship for financial services. However, contingency plans do not make any assumptions that this future relationship will be any less limited than other third countries' have today.

Steering committee

The bank set up a programme specifically in relation to the planning and preparing for Brexit and to coordinate the potential impact and the response the bank is taking. The programme reports directly into the Group's Executive Committee and assesses the progress being made with applications for the necessary regulatory licensing requirements with the relevant authorities. The internal audit function receives weekly updates on the project status of the various work streams and any concerns raised by the different departments. It has audited the programme and monitored its developments continuously and will do so for the foreseeable future.

In addition, a new steering committee is being set up by the bank's risk function to oversee some of the more practical issues related to Brexit. Internal audit will attend all meetings to have oversight of key events and responses but to also raise questions and challenge assumptions and findings. The audit work undertaken so far has enabled internal audit to get a clear view of the bank's preparations and has provided it with various opportunities to raise concerns with the appropriate people at different governance fora.

Due to the complexity of Brexit, senior management and the board have taken a strong interest in the bank's preparations for the UK's withdrawal from the EU. The audit function found that some practical elements associated with Brexit have become less risky as a direct consequence of senior management's oversight and involvement.

Advice

For any internal audit function it is important to consider the implications of Brexit to its own activities. The bank's function is now required to allocate more resources to its non-UK locations and is reviewing where its staff will be required to operate, how many additional resources are needed, to what extent it complies with different national regulations, and the effects on its audit budget. It stresses the need to be flexible to respond to shifting priorities and developments and to assure its time and focus is appropriately allocated.

Large UK financial services institution

Chief Internal Auditor

Like many other financial services organisations, the company operates globally with a particularly large customer base in the UK, US and in Asia. As a consequence, the company has limited exposure to the negative trading effects of Brexit. It has, however, established a subsidiary in another EU country to support its European clients after 29 March 2019. Although the impact of Brexit is a risk, the organisation prepares for and models many significant economic and business stress scenarios as part of its normal business operations.

Due to the ongoing negotiations between the UK and the EU, the uncertain outcome has the potential, among other things, to create additional asset price volatility impacting certain businesses within the organisation. Although the impact of Brexit is a risk, the financial market impact of wider geo-political events continue to be a focus for the organisation's risk outlook, such as ongoing political tensions between the United States and China and their tit-for-tat trade war, and the imposition of sanctions on Russia by the EU and the US.

In the event of a no-deal outcome, the biggest impact the business foresees is the additional potential volatility in financial markets and any potential secondary impact of an economic slow-down. A potential slow-down in the UK economy would affect investment values and the risk of credit defaults. One of the key short-term effects of Brexit uncertainty has been exchange rate fluctuation between Sterling and other major currencies which have had both a positive and negative impact on the organisation's financial results as businesses outside the UK have performed well due to the lower value of Sterling.

EU staff

One area that the business is focussing on is its European staff operating in the UK. As a large financial services firm, it employs many EU nationals in technical and senior roles. Its HR department has identified the individuals that might be impacted by potential restrictions to free movement of labour and its impact on the workforce and its operating model. The key priority has been to provide early assurance on their right to work in the UK and give them appropriate support in making applications for visas or Settled Status in case of a no-deal Brexit.

Scenario planning

Like most other organisations the business has undertaken scenario planning by giving considerable thought to the practical implications a hard or soft Brexit will have. It found, however, that most scenarios will not have a significant impact on its business model due to its limited exposure to the negative effects of Brexit.

The organisation employs a large number of financial experts who conduct analysis on different global events which allowed the organisation to map out the different scenarios in great detail. In addition, the organisation sought expert third party advice that provided different perspectives and practical suggestions that would have otherwise perhaps not been considered by the organisation.

It also engages in regular discussions with government and regulators who are keen to understand the organisation's planning and thinking and the effects Brexit has on the wider UK financial services infrastructure.

Internal audit

Preparing for the UK's departure from the EU is considered a key business priority and as such the organisation set up an internal Brexit working group. The working group is run by the second line of defence's risk function and meets frequently to ensure that information is shared across the firm. The internal audit function has a seat at the table which allows it to challenge assumptions, whether these have changed over time and if they are still relevant. Examples of challenge included the assessment of third party downstream and upstream supply chain risk. Other functions attending the working group are senior management, representations of group divisions, and first and second line functions like compliance, HR and legal.

Sitting on the working group also gives the internal audit function clear oversight and understanding of the impact and processes around setting up, for example, new entities in other EU countries, and the consequential impact of this for the internal audit function itself in terms of the provision of audit resources for the newly set up subsidiaries and complying with national regulatory requirements.

Internal audit considered Brexit as any other change programme but recognises that political and economic developments require the organisation to be more agile. Some issues around a future relationship between the UK and the EU have become clearer, while other issues remain unresolved. The internal audit function used its role to assess the robustness of the first and second lines' underlying assumptions, whether these are still relevant and, finally, to evaluate the effectiveness of the measures that were implemented to mitigate the risks.

Large UK retailer

Head of Internal Audit

As a large UK based retailer, the impact on the organisation following the Brexit referendum has been the currency exchange rate fluctuation between Euro and Sterling. Brexit continues to drive higher UK domestic inflation and increased import costs from a weaker Sterling, worsened by new import duties and tariffs, with a consequential wider economic impact. The collapse in the pound has pushed up prices and a possible no deal outcome could lead to higher food prices and major supply chain issues.

The organisation has a deep and rich supply chain across Europe as it imports large quantities of food products into the UK. Most goods require frictionless cross-border access, so it is vital that its products can be imported without delays and disruption. The immediate consequences of putting in place physical border controls will mean that lorries carrying fresh produce will be forced to undergo lengthy checks at UK ports, which may cause deterioration in the products increasing waste and driving up costs for customers.

Another area of concern has been its supply chain's large reliance on EU nationals working in the British agri-food sector and which are particularly vulnerable to the prospect of future changes to immigration policy for EU migrants.

The uncertainty around a potential outcome has led the organisation to mitigate and offset the above risks by reviewing its supply chain and by actively looking into alternative sources of supply within the UK but also outside the EU to source food and drink deliveries to its stores. It has already mapped out alternative sourcing locations for goods that could face the biggest tariffs if the UK leaves the EU without a deal, relying instead on WTO rules.

In addition, it is looking into possibilities to assist its suppliers in recruiting British staff to secure the labour supply. Many UK farmers are highly dependent on thousands of seasonal low-skilled workers, a large majority of them coming from EU countries.

Preparing for Brexit

Like many other organisations, the retailer primarily focussed on a hard Brexit outcome as it would be the most disruptive to the organisation. In this scenario, retailer profits would decline significantly because of higher tariffs, procurement difficulties and a decline in the value of Sterling.

It has spent a minimum amount of resources on a soft Brexit outcome, referring to a scenario where the UK stays either within the EU's Single Market or in the European Customs Union, or both. It is confident that the business is prepared for a soft Brexit and, as a positive consequence of this, has minimised its workload by only focusing on its worst-case scenario, a hard Brexit.

The uncertainty around Brexit is also considered disruptive but the organisation found the government's recent technical notices on importing and exporting helpful in preparing for Brexit in the event of a no-deal Brexit.

The risk and oversight of Brexit has been owned by the Executive Committee and not a standalone committee. Brexit was recognised as a principal risk early on and the internal audit and risk function has supported management to identify risks and their potential impacts on the business. The internal audit function supported management in their own work to assess the impact of Brexit.

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First established in 1948, we obtained our Royal Charter in 2010. About 2,500 members are Chartered Internal Auditors and have earned the designation CMIIA. Over 1,000 of our members hold the position of head of internal audit and the majority of FTSE 100 companies are represented amongst our membership.

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Chartered Institute of Internal Auditors

13 Abbeville Mews
88 Clapham Park Road
London SW4 7BX

tel **020 7498 0101**

email **info@iia.org.uk**