

To the Point

Companies should consider the effects of the current economic environment and tariffs on their accounting and financial reporting

Because trade policy continues to evolve, companies should monitor developments for potential effects on their operations.

What you need to know

- ▶ Companies should consider the effects of the current economic environment and tariffs on their accounting and financial reporting. This includes determining whether the potential risk factors associated with tariff exposure, material risks to financial performance or other factors are significant enough to warrant disclosure.
- ▶ Companies need to closely monitor developments and determine the implications for their businesses and their internal control over financial reporting.

Overview

Companies should consider the effects of the current economic environment, including tariffs imposed by the US and other countries outside of the US, on their accounting and financial reporting. Tariffs are a form of taxes levied by governments, often as a fixed percentage of the value of imported goods, that are designed to increase the cost of foreign product imports, making them less competitive compared to domestic products.

President Donald Trump in April announced tariffs on a wide range of goods, including a 10% base rate on all imports, with higher rates for certain countries. President Trump said the tariffs were intended to address trade imbalances. The US Court of Appeals for the Federal Circuit stayed a decision by the US Court of International Trade that found the Trump administration had not met the legal requirements to levy the tariffs and scheduled oral arguments for later this summer. Because trade policy is constantly evolving, companies should monitor changes for potential effects.



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Since tariffs are generally based on a percentage of the value of a product, they are not accounted for as an income tax and are capitalizable costs (e.g., inventory; property, plant and equipment). This publication highlights certain accounting and reporting considerations related to the tariffs.

Key considerations

Prospective financial information

Management should carefully evaluate the implications of the current economic environment and tariffs on projections and other assumptions used in preparing the financial statements, including determining how tariffs may affect cash flow projections used in prospective financial information (PFI). Companies also may need to consider how uncertainty caused by tariffs could affect the discount rate. Projections should be consistently applied (e.g., measurement of fair value, long-lived asset impairment tests, goodwill impairment tests, realizability of deferred tax assets tests) and should reflect the effects of the current economic environment, including tariffs.

Asset impairment

Since tariffs increase the cost of assets that are imported, if a company is unable to pass these rising costs on to customers, the carrying amount of the assets (or asset groups) may not be recoverable (e.g., property, plant and equipment; inventory) and should be evaluated for impairment. Companies should also consider whether the current economic conditions affect the recoverability of other assets (e.g., equity method investments, deferred tax assets) or indicate that it is more likely than not that an impairment exists (e.g., goodwill and indefinite-lived intangible assets).

Revenue

Companies should consider whether changes in pricing of existing customer contracts due to tariffs will likely need to be accounted for as variable consideration or a contract modification. If an existing contract contains legally enforceable terms that allow an entity to pass the increased costs of tariffs to their customers automatically, any change in the transaction price would be accounted for as a change in the estimate of variable consideration and, generally, allocated to the performance obligations on the same basis as their initial allocation at contract inception. If price changes resulting from tariffs need to be separately negotiated and agreed to with the customer, the contract modification guidance under Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, should be applied once the modification is enforceable.

Tariffs may affect the measure of progress for over-time performance obligations under which a cost-to-cost input method (i.e., costs incurred relative to total expected costs) is applied to measure an entity's progress toward satisfaction of the performance obligation to recognize revenue.

Entities in the scope of loss contract guidance (e.g., contracts in the scope of ASC 605-35, *Revenue Recognition – Provision for Losses on Construction-Type and Production-Type Contracts*) will need to consider whether increased costs related to tariffs would result in an expected loss that should be recorded.

Share-based payment awards

The significant uncertainty in the current environment may prompt companies to amend the terms and/or conditions of share-based payment awards to keep grantees incentivized. A company applies modification accounting if amendments change the fair value, vesting

conditions or classification of the award. When applying modification accounting, the company generally determines on the date of the modification whether it is probable (i.e., the future event or events are likely to occur), based on current circumstances, that the awards would vest under the original vesting conditions, the new vesting conditions or both.

Contingencies

Contingent liabilities differ from other regulatory, legal and contractual liabilities. When a company has a regulatory, legal or contractual obligation to pay a tariff, the amount of that obligation (e.g., the applicable tariff rate) is usually clear. In these cases, tariff liabilities are generally recognized, measured, derecognized and disclosed in accordance with other US GAAP guidance on liabilities (e.g., ASC 405, *Liabilities*). When it is not clear whether an obligating event to pay a tariff has occurred or what amount is required to be paid (e.g., there is ambiguity in the tariff policy), a company should apply the guidance in ASC 450-20, *Contingencies – Loss Contingencies*, to recognize and measure tariff liabilities.

Subsequent events

A subsequent event that provides evidence about conditions that did not exist at the balance sheet date (i.e., those that arose after that date) is not recognized in the financial statements. A tariff that is levied or amended after the balance sheet date is generally a nonrecognized subsequent event. However, such a nonrecognized subsequent event may need to be disclosed to prevent the financial statements from being misleading. Such disclosure should include both the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.

Internal control over financial reporting

A company's internal control over financial reporting (ICFR) assessment should be designed to evaluate risks of material misstatement resulting from the current economic environment, including the above key considerations related to tariffs. They should consider disruptions to operations, customers and suppliers in evaluating whether existing controls continue to be designed and operating at an appropriate level to mitigate risks of material misstatement to the financial statements. Companies will also need to make sure their controls around disclosures are designed and operating effectively so they can produce complete and accurate disclosures that reflect timely and relevant information.

Interim reporting

Inventory

Inventory losses should not be deferred beyond the interim period in which the decline occurs, unless the decline can be reasonably expected to be restored within the same fiscal year. Such temporary declines do not need to be recognized at the interim date since no loss is expected to be incurred in the fiscal year. If inventory is written down as of an interim date, recoveries of such losses on the same inventory in later interim periods of the same fiscal year need to be recognized as gains in the later interim periods. However, the amount of gains recorded by an entity should not exceed the previously recognized losses.

Income taxes

A company is required, at the end of each interim reporting period, to make its best estimate of the annual effective tax rate for the full fiscal year and use that rate to provide for income taxes on a current year-to-date basis. When a company is unable to estimate a part of its ordinary income (loss) or the related tax expense (benefit) but is able to make a reliable estimate of its estimated annual effective tax rate (EAETR), the tax expense (benefit) applicable to the item that cannot be estimated should be reported in the interim period in

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which the item is reported. If a company is unable to make a reliable estimate of its EAETR, the actual effective tax rate for the year to date may be the best estimate of the annual effective tax rate.

Financial statement disclosures

Financial statement disclosures for companies will vary based on the magnitude, duration and nature of the effects of the current economic environment, including tariffs, on their businesses and the availability of information required to make the disclosures.

A company may be required under ASC 275, *Risks and Uncertainties*, to disclose certain significant estimates and concentrations (e.g., concentration of business volume in a market or geographic area) that make it vulnerable to the risk of a near-term severe impact. In addition, management is required to make its going concern evaluation and provide the relevant disclosures for both annual and interim reporting periods. Companies will need to consider the current economic environment, including tariffs, in their evaluations.

SEC reporting and disclosures

Companies should consider the current economic environment, including tariffs, when disclosing any unusual or infrequent events, transactions or significant economic changes that materially affected income from continuing operations in management's discussion and analysis. They are also required to disclose known trends or uncertainties that have had, or are reasonably likely to have, a material effect on their revenue or income from continuing operations, liquidity or capital resources.

Companies are required to disclose in each quarterly report on Form 10-Q any material new risks or changes in risk factors previously disclosed in their annual report on Form 10-K. They should also consider the need to update their risk factor disclosures to reflect the effects of the current economic environment, including tariffs. If matters previously disclosed as potential future risks have materialized, companies should update disclosures to no longer characterize them in a hypothetical fashion.

How we see it

Given the current economic environment, including tariffs, companies need to continuously evaluate the related effects on their business and financial reporting, provide disclosures on the material effects and update the disclosures as circumstances change. Companies should avoid using boilerplate language in their disclosures and instead provide specific, tailored information that allows investors to evaluate the current and anticipated effects of the current economic environment, including tariffs, from the perspective of management.

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