CFO SERVICES

Tariff Impacts

Top 10 Accounting and Financial Reporting Issues

As U.S. tariff policies continue to evolve, the accounting implications for portfolio companies can be surprisingly extensive. While many of our clients are focused on addressing the immediate operational challenges caused by tariffs, like supply chain disruption, management teams should also be prepared to address accounting considerations, including a slew of potential accounting and financial reporting issues stemming from the impact.

Many public companies are already in the midst of addressing certain of these tariff impact reporting challenges in quarterly filings. For private companies, these issues are likely to develop as we move closer to year-end and auditors begin their work.

To get in front of these topics, we compiled a list of the top 10 accounting and financial reporting issues of tariff impacts management teams need to consider in order to avoid being caught off guard. Whether the magnitude or timing of tariff imposition leads to broader changes in pricing, cost structures or resulting margin changes is beyond the objective of this summary. Given the pervasive nature of this issue, we believe the topics raised are also highly relevant for financial due diligence (FDD).

Our **top 10 key accounting and financial reporting issues** to consider in the current market environment are as follows:

1. **Tariff capitalization into inventory** — Inventory costs include all direct and indirect costs incurred to prepare an item for sale, such as the purchase price as well as any overhead, in-bound freight and taxes — including tariffs. Tariffs are a form of tax paid by an importer, and the amount of the tax will be dependent on the country of origin. As the amount and timing of the tax continues to evolve, companies will need to make sure they have a robust process in place to capture and track these incremental costs.

2. **Higher inventory balances could lead to potential impairment charges** — Elevated inventory costs increase the risk for impairment. Inventory balances would need to be assessed using the lower of cost or net realizable value (NRV) framework at the balance sheet date. NRV is the estimated selling price of an asset in the ordinary course of business, less the estimated costs of completion, disposal and transportation. This assessment, which relies heavily on management's assessment of NRV, could necessitate contract-level reviews to ascertain a company's ability to raise customer prices, such as through pass-through costs, especially those subject to longer-term contracts. Some companies have advanced inventory purchases to get ahead of potential tariffs. While this could negate the impact on operating margins from increasing tariff costs, it could also lead to sizable inventory balances at reporting dates.

3. **Inventory standard costing processes may need to be more frequently updated** — Manufacturing companies often use standard costing to account for inventory. Any difference between actual and standard costing is typically tracked in a separate variance account for potential capitalization. As noted above, accounting guidance dictates that tariff costs are capitalizable and are not considered 'abnormal' costs that are accounted for as period costs. Therefore, standard costing methodologies may need to be more frequently updated in the current economic environment.

4. **Fixed asset value impacts** — Similar to inventory, any tariff costs incurred for the purchase of fixed assets is capitalized as part of acquiring an asset. Therefore, in addition to capturing the costs, companies may need to assess the risk for potential fixed asset impairment at year-end. Moreover, given the broader impact on company operations and profitability, the risk of other asset impairments, such as goodwill, may also increase. This risk may amplify if impairments of certain assets subsequently trigger the review of other asset classes.

5. **Revenue recognition impacts from price changes** — The tariff impact on revenue recognition depends on the terms of the underlying contracts. Where tariff-related price changes are contractually stipulated, accounting guidance dictates that they be accounted for as variable consideration. Conversely, if the price change is negotiated separately by the vendor, it will be evaluated as a contract modification or taken into account in future revenue contracts. Companies may also need to evaluate the impacts on their established Standalone Selling Price (SSP) for goods and services, while also considering the potential downstream effects to bill and hold arrangements, material rights considerations, and long-term pricing arrangements, to the extent applicable.

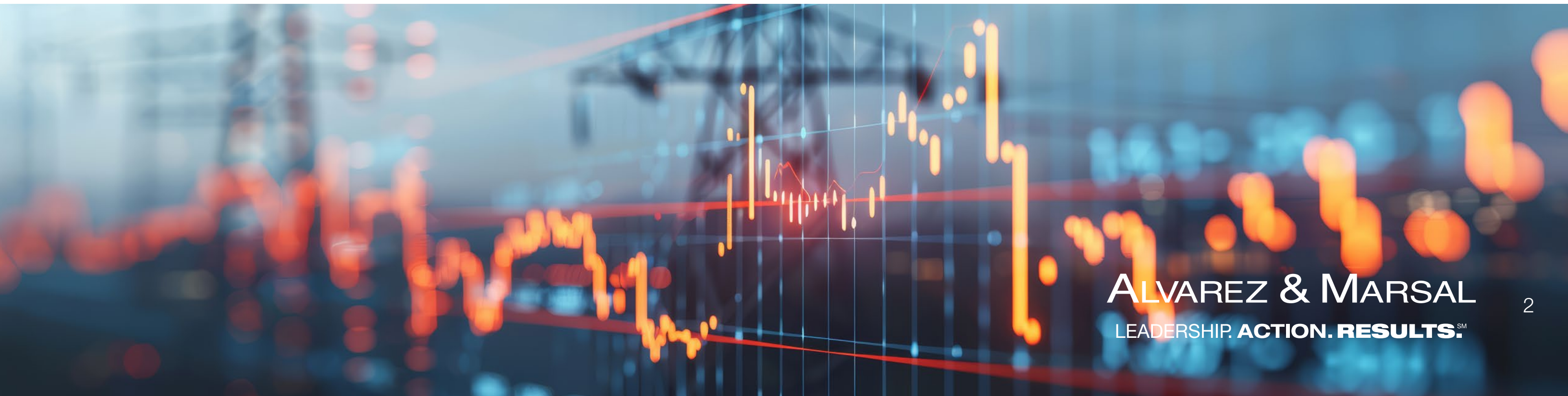
6. **Revenue recognition impact for POC-based companies** — Companies that use over-time revenue recognition, such as percentage of completion (POC), and cost-to-cost methods are also likely to be affected by the new tariff impacts. Since costs are the input when measuring progress for purposes of recognizing revenue, any incremental tariff costs will need to be reflected in the progress calculations, including estimating the total costs at completion under a contract. This process may be particularly challenging, given the vast uncertainty about the magnitude and duration of tariff policies. In addition, if tariff-related costs cannot be passed onto the customer, the risk of the long-term contract becoming a loss contract increases, which would require immediate expense recognition.

7. **Deferred taxes** — Companies should consider the impact on any deferred tax assets and related valuation allowance. Because they are based on the expected future profitability of the entity, deferred tax impacts are set to change as profitability is likely to be impacted by tariffs and the expected ability to pass higher costs on to customers.

8. **Transfer pricing implications** — Companies may need to revisit the impact on any transfer pricing arrangements to the extent supply chain changes are implemented and goods are moved across various subsidiaries. Actions taken to mitigate the potential impacts of new or increasing duties could give rise to new uncertain tax positions that have to be accounted for.

9. **Foreign currency fluctuations** — Given the recent turmoil in foreign currency movements due to market uncertainty and tariff implementations, companies will need to consider the implications from the volatility and its impact on financial reporting both on the balance sheet and income statement.

10. **Going concern analysis** — Working capital deficiencies, negative operating cash flows and a persistently high-interest rate environment will likely put pressure on a company's assessment of its ability to continue as a going concern. Heightened global trade uncertainty is likely to hinder companies from developing reasonable support to address these critical matters. This could further impact compliance with financing agreements and the ability to meet debt service requirements over a one-year time horizon after the date financial statements are issued. Companies that are experiencing uncertainty regarding their ability to continue as a going concern should evaluate whether their current mitigating plans will alleviate the substantial doubt, or whether revisions to these plans are needed.



Tariff Uncertainty Along With Accounting and Financial Reporting Issues Will Continue

The early stages of tariff implementation are just beginning, so the topics above are likely to continue to evolve as companies deal with numerous uncertainties from tariff impacts. Beyond the issues noted, other matters specific to FDD could develop. For example, tariffs are likely to have a near-term net working capital impact to the extent a company is unable to pass through all or a portion of the higher costs. Seasonal businesses will be particularly impacted, as they will immediately incur higher costs without the ability to recoup those costs until sometime later when sales occur.

We also expect to see changes in potential addbacks. For example, similar to what occurred during the COVID pandemic, we could see a myriad of future addbacks relating to the current tariff dynamic, including industries that could face global trade disruptions including and accelerating addbacks for supply chain optimization and related impacts.

If you have any questions about the tariffs impact on accounting and financial reporting, please contact an A&M financial professional.

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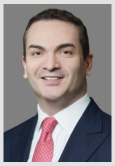

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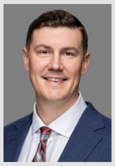

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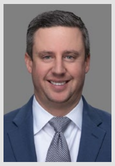

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