ACCOUNTING IN TIMES OF UNCERTAINTY: THE EFFECTS OF VOLATILE 2025 TARIFFS

Throughout 2025, various governments have stated an intention to increase tariff rates on a wide variety of imported goods and/or services. Certain jurisdictions have begun levying tariffs on these imports, with significant uncertainty about the timing of levies and how long these policies will endure. Due to this uncertainty, and the complex nature of international supply chains, the operational and financial effects of tariffs on entities are challenging to predict.

This uncertainty results in numerous accounting implications such as impairment of financial and non-financial assets; going concern; significant judgements, estimates and estimation uncertainty and others.

ACCOUNTING IN TIMES OF UNCERTAINTY

Impairment of non-financial assets

Tariffs may increase the costs of production, reduce the demand for goods and services and have other indirect effects, which may increase the risk of impairment of non-financial assets, including property, plant and equipment, right-of-use assets, intangible assets and goodwill.

IAS 36 Impairment of Assets requires that an impairment test be performed on goodwill at least annually, with an impairment test of other assets being performed when indicators of impairment are present. The existence of threats of increased tariffs affecting an entity's operations may result in impairment indicators being identified, triggering impairment tests.

Entities should exercise greater caution with respect to impairment if the entity is significantly affected by factors such as:

- Significant amounts of revenue derived from one or more jurisdictions where tariffs have been imposed on the entity's goods and services;
- Significant uncertainty concerning whether tariffs will be imposed and/or increased on the entity's goods and services;
- Significant exposure to supply chain stresses, such as increased input costs from imported goods;
- Significant increases in costs on account of inflationary factors as a consequence of tariffs; and
- An inability to pass-on increases in costs to customers.
- Some important considerations when performing an assessment of impairment of non-financial assets are:
- Determination of an appropriate discount rate;
- Inputs used for value-in-use calculations should reflect the entity's expectations about the future cash flows the entity expects to derive from the asset(s), which may include lower revenues and/or higher costs as a result of tariffs;

Fair value measurement

Tariffs and general macroeconomic uncertainties may lead to an increased level of uncertainty with respect to inputs used for the determination of fair values. Entities need to consider the effect of current macroeconomic conditions on fair value measurements, particularly with respect to Level 3 inputs and on the disclosures provided.

Discount rates

A number of IFRS Accounting Standards require discount rates to be determined. In the current economic environment with tariff uncertainty, the potential for high inflation and a general economic downturn, the determination of discount rates is critical and discount rates determined in the past may no longer be appropriate. In many cases, discount rates may need to increase compared to prior reporting periods (e.g. discount rates used to estimate the recoverable amount in an impairment test).

Some of the factors that need to be considered when determining the discount rate are:

- Avoiding double-counting of risks or omitting the effects of some risk factors when estimating fair value or value in use

As required by IFRS 13.B14(c), to avoid double counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows. If the cash flow estimates are adjusted for certain risks, the discount rate should not reflect that risk. Similarly, IAS 36.55(b) requires the discount rate to include '…risks specific to the asset for which the future cash flow estimates have not been adjusted'.

- Pre-tax vs post-tax discount rate

IAS 36.55 and IAS 37.47 require use of a pre-tax discount rate.

Entities often use weighted average cost of capital (WACC) as a starting point for determining the discount rate to be used for IAS 36 and IAS 37. WACC is usually a post-tax rate which needs to be converted to a pre-tax rate to comply with the requirements of IAS 36 and IAS 37. In simple scenarios, the pre-tax rate may be arrived at by grossing up the post-tax discount rate by the standard rate of tax. However, as noted in IAS 36.BCZ85, this may not always give the correct result. In complex scenarios or where multiple tax rates are involved, entities may need to apply an iterative process to arrive at the appropriate pre-tax rate.

- Internally consistent assumptions

Assumptions about the discount rate and cash flow estimates should be internally consistent. Cash flows are discounted using the discount rate applicable for the currency in which the cash flows are denominated. The discount rate is determined considering the underlying economic factors of the currency in which the cash flows are determined.

- Real vs nominal discount rate

Nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation. In a high inflationary environment, it is essential to ensure this consistency. An error here may give a result that is materially incorrect.

- Specialist involvement

Entities may need to involve a specialist to determine the discount rate if the choice of discount rate is expected to have a material effect on the measurement of assets and liabilities. This may be appropriate in a high inflation and high interest rate environment, and as a result of uncertainty caused by the introduction, or changes in the rates, of tariffs.

- High quality disclosures

Determination of discount rate may involve significant judgement or be a source of significant estimation uncertainty. In such cases, entities need to provide clear, entity-specific disclosures of how the discount rate was determined, including the assumptions used.

Going concern

Due to deteriorating economic conditions, many entities have experienced (or may expect to experience) a significant downturn in revenue, rising costs or both. Certain industries may experience significant reductions in revenue as a result of reduced demand for their goods and services globally due to the effects of tariffs. Rising debts may be difficult for some highly leveraged entities. Entities may not be able to pass on the rising operating costs to customers in all cases.

IAS 1.25 requires an entity to disclose material uncertainties related to its ability to continue as a going concern. However, IAS 1.122 and IAS 1.125 contain overarching requirements to disclose significant judgements, assumptions and sources of estimation uncertainty. It should be noted that these overarching requirements also apply to the going concern assessment. Therefore, entities are required to disclose significant judgements, assumptions and sources of estimation uncertainty involved in their going concern assessment.

Interim financial reporting

Entities that prepare interim financial statements in accordance with IAS 34 *Interim Financial Reporting* must consider all of the recognition and measurement matters discussed in this publication. However, specific additional considerations also apply to interim financial statements.

IAS 34.15 requires entities to include "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. Information disclosed in relation to those events and transactions shall update the relevant information presented in the most recent annual financial report".

If the effect of tariffs and general macroeconomic conditions have changed since the end of the entity's last annual reporting period, entities may need to provide substantial disclosures in interim financial statements.

As noted in the impairment of non-financial assets section of this publication, the effects of tariffs may result in indicators of impairment, triggering impairment tests and potential impairment losses in interim periods.

Judgements, estimates and estimation uncertainties

Significant judgements and estimates are involved in a number of areas of financial statement such as impairment assessment, fair value measurements, accounting for deferred taxes, employee benefits, inventory valuation, assessment of control/joint control/significant influence, contingent consideration, and expected credit loss (ECL) measurements.

In times of uncertainty, judgements, estimates and estimation uncertainties have an even more critical role in accounting. Given the rapidly evolving circumstances, significant judgements and estimates need to be assessed, updated and monitored continuously to ensure that they reflect current circumstances. Entities may need to revise their assumptions and valuation models to consider multiple scenarios and possible outcomes. For example, due to reductions in demand for goods and services and increased costs, entities may need to revise their assumptions used to determine the recoverable amounts of non-financial assets. Entities in sectors that are particularly affected by increased tariffs may need to consider multiple scenarios with varying assumptions in their cash flow projections to estimate the recoverable amount in impairment analysis of non-financial assets.

Events after the reporting period

IAS 10 *Events after the Reporting Period* defines events after the reporting period as events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue.

Entities need to determine whether the event after the reporting period is adjusting (events that provide evidenbce of conditions that existed at the end of the reporting period) or non-adjusting (events that are indicative of conditions that arose after the reporting period). This assessment may require significant judgement.

Amounts recognised in financial statements are adjusted to reflect material adjusting events. For material non-adjusting events, the entity should disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.

Times of uncertainty and rapid change increase the risk that a material event will occur after the reporting period but before the financial statements are authorised for issue, making this assessment a critical one. Entities should monitor and assess on a continuous basis to identify and account for material events after the reporting period.

Other financial reporting effects

Economic uncertainty and increased tariffs may have other financial reporting implications, such as:

- IAS 1 *Presentation of Financial Statements*

Amendments to IAS 1 effective for annual reporting periods on or after 1 January 2024 modified the criteria that must be met in order for loans to be classified as non-current.

Economic uncertainty as a result of tariffs may result in increased uncertainty about whether entities will comply with covenant tests within the next 12 months. Therefore, entities must carefully consider the requirements of IAS1.76ZA and provide adequate disclosures.

- IAS 12 *Income Taxes*

Entities must consider whether previously recognised deferred tax assets are still recoverable given increased economic uncertainty.

- IFRS 2 *Share-based Payments*

Economic uncertainty may have macro-economic effects such as lower demand for goods and services. This may affect entity's performance and have a corresponding effect on share-based payments with performance conditions (e.g. the entity meeting certain revenue or net income targets).

- IFRS 9 *Financial Instruments*

- Inflationary clauses in contracts.

  There may be inflationary features embedded in revenue, supply, leasing and other financing contracts. The entities need to evaluate whether these need to be separated and accounted for as a derivative. The entities need to disclose information relevant to the users' understanding related to such inflationary clauses in the financial statements.

- Rising inflation will have an effect on the measurement of ECL. Increased economic uncertainty may lead to an increase in default risk and the associated measurement of ECL.
- There may be greater number of instances of debt modifications where borrowers are not able to service the debt on due dates.

- IFRS 15 *Revenue from Contracts with Customers*

Significant changes to input costs may result in entities entering into negotiations with customers to increase the prices of goods and services. Increased costs as a result of tariffs may also result in the triggering of pre-existing contractual terms which permit entities to increase prices. Entities must carefully consider whether these circumstances give rise to contract modifications.

Additionally, increases in costs may affect an entity's measure of progress for contracts where revenue is recognised over time.

- IFRS 16 *Leases*

Modifications to lease contracts require lessees to reassess the discount rate used to measure the lease.

- IAS 2 *Inventories*

Inflation may lead to increases in estimated costs necessary to make a sale. If the estimated selling prices do not increase correspondingly, for example in case of long-term fixed rate contracts, this may lead to a reduction in the net realisable value and possibly higher inventory write-downs.

- IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

Governments may provide loans at below market rate of interest to some entities, which need to be accounted for in accordance with IAS 20. It should be noted that for existing loans, reassessment of whether the loan is below-market rate of interest is not required or permitted under IAS 20.

- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Contracts may become onerous due to increase in costs without a corresponding increase in revenue. For example, if rising input costs mean that the costs of constructing a building for a customer have increased such that the contract is no longer profitable, that contract may be onerous. Onerous contracts are required to be recognised as a provision with the loss being recognised 'up front'.

Financial instruments

The following are factors related to financial instruments that entities should be mindful of:

- Expected Credit Loss (ECL) models

Entities, especially financial institutions, may face significant challenges in developing ECL models for the current macroeconomic environment due to lack of experience in modelling for such circumstances. Therefore, it is critical to provide sufficiently transparent disclosures of the effect of the changing economic environment on the ECL calculation. This would enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows.

Different groups of borrowers may be affected differently by the current macroeconomic developments. For example, the effects of rising tariffs may affect particular industries and jurisdictions more than others. Therefore, entities should consider providing enhanced disclosures of sector-specific drivers in ECL measurement and risk concentrations related to specific sectors and/or jurisdictions.

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If you have any questions about the information in this newsletter, please speak to your usual BDO contact or get in touch with BDO in Thailand's IFRS team at ifrsthailand@bdo.th.