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Public Cos. Must Heed Disclosure Risks Amid Trade Chaos

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Ongoing uncertainties caused by the trade war and President Donald Trump's evolving stance on tariffs and trade restrictions, including sanctions and export controls, have exponentially escalated financial reporting pressures on public companies.

In this article, we discuss the key financial reporting and disclosure risks, as well as takeaways, for public companies as they navigate significant market instability in international trade.

Background

Trade tensions have spiraled over the past two months, after Trump announced that the U.S. would impose 145% tariffs on Chinese imports, and China responded by announcing 125% tariffs on U.S. imports.

The U.S. tariffs on Chinese imports went into effect on April 9, as the exception to Trump's decision to suspend reciprocal tariffs imposed on most of the U.S.'s other trade partners for 90 days.[1]

On May 12, the U.S. and China announced a 90-day rollback of these tariffs. The U.S. will reduce the tariff on Chinese imports to 30%, and China will reduce the tariff on U.S. imports to 10%.

This is the most recent example of how Trump has imposed — and in some cases, paused, reversed and again reinstated — a wave of tariffs on imports from over 50 U.S. trading partners, and on specific commodities ranging from steel to car parts to electricity.[2] There is considerable uncertainty regarding the final resolution that the U.S. and China will ultimately reach as a result of the ongoing negotiations.

In anticipation of tariff activity, some home building companies responded by stockpiling hundreds of thousands of dollars of supplies imported from countries like Canada and Mexico to protect themselves from higher import costs.[3] Notably, Trump announced, then shortly thereafter paused, 25% tariffs on most Canadian and Mexican imports, causing uncertainty and frustration.[4]

Other industries, including consumer retail, have cut their financial forecasts for the year, predicting lower sales and profits, in part due to Trump's tariff policy, which has triggered retaliatory tariffs from foreign governments on American goods.[5] Companies are facing increasing risks from the evolving landscape of sanctions and export controls.

As part of its "America First" trade policy, the Trump administration views export controls as a tool to strengthen economic and national security. The policy states that the U.S. "must ensure that its advanced technology does not flow to our adversaries," and that "[e]xport controls should be simpler, stricter, and more effective, while promoting U.S. dominance in AI and asserting global technological leadership."[6]

Specifically, the policy directs the secretaries of state and commerce to "assess and make recommendations regarding how to maintain, obtain, and enhance our Nation's technological edge and how to identify and eliminate loopholes in existing export controls — especially those that enable the transfer of strategic goods, software, services, and technology to countries to strategic rivals and their proxies."[7]

More recently, the head of the U.S. Department of Justice's Criminal Division disseminated a memorandum to all division personnel refocusing its priorities with regard to white collar crime.[8]

The memorandum identifies as a key threat to U.S. national security "trade and customs fraudsters, including those who commit tariff evasion, seek to circumvent the rules and regulations that protect American consumers and undermine the Administration's efforts to create jobs and increase investment in the United States."

Specific Criminal Division priorities relating to international trade and sanctions include prosecuting trade and customs fraud, including tariff evasion, and conduct that threatens the country's national security, including threats to the U.S. financial system by gatekeepers, such as financial institutions and their insiders that commit sanctions violations.

Some companies have already announced losses in the billions due to trade restrictions imposed by the White House.

A notable example is Nvidia Corp., the industry-leading AI chip designer, which has faced the imposition of an export license requirement on shipments to China of its H20 chip, designed specifically for the Chinese market.[9] Nvidia recently announced that it is downgrading the design of the H20 chip in an effort to eliminate the licensing requirement.[10]

The uncertainty is far from over. On May 28, in V.O.S. Selections Inc. v. U.S., a panel of federal judges in the U.S. Court of International Trade blocked many of Trump's tariffs, declaring them illegal and "exceed[ing] any authority granted" to the president by federal law.[11]

A day later, on May 29, the U.S. Court of Appeals for the Federal Circuit stayed the CIT order, temporarily reinstating Trump's tariffs pending the government's appeal.[12]

As courts continue to review Trump's tariff policies, and as Trump continues to engage in talks with foreign countries and announce new changes to his policies on tariffs and trade, public companies must stay up to date with ongoing developments to adjust their business strategies and ensure compliance with various reporting and disclosure obligations.

The Impact of the Trade War and Tariffs on Public Companies

Public companies face several financial reporting and disclosure risks relating to the true impact of the trade war — including potential or actual tariffs, export controls and sanctions — on their business operations and financial results.

Fundamentally, these risks can negatively affect a company's earnings — i.e., its net income after all expenses, including taxes — and lead to the disclosure of material risks affecting the business, because the company faces potentially higher costs of doing business in a trade war.

In the U.S., public companies must navigate these risks in light of their requirement to follow generally accepted accounting principles, which prescribe rules and standards ensuring the consistent disclosure of how they report their revenues, costs and estimated losses.

The U.S. Securities and Exchange Commission has traditionally viewed financial reporting issues as part of its core enforcement mission. For instance, the SEC has brought numerous cases against public companies that manipulated the cost of goods sold, or inflated revenues[13] or inventory value.[14]

In the context of the trade war, these risks are amplified, given that the SEC has also brought numerous cases against public companies for violations of the books and records and internal controls provisions of the Securities Exchange Act of 1934, over internal accounting controls that failed to prevent the concealment of commercial transactions with restricted countries in an effort to evade U.S. sanctions and export controls.[15]

In this administration, the SEC will likely continue to investigate public companies that misrepresent identities of suppliers and customers to avoid the impact of sanctions and tariffs, falsely improve their profit margins by not recording costs associated with sanctions and tariffs, intentionally conceal disappointing financial performance in key parts of their business, or otherwise engage in accounting fraud to mislead investors.

Public companies are adjusting to a shifting geopolitical landscape in which the Trump administration has imposed tariffs on exports from specific countries, including China. Moving supply chains from one country to another, however, takes time and resources.

Below we discuss the primary enforcement risks that public companies face in ensuring the accuracy of their financial statements and SEC filings in light of the trade war, tariffs and sanctions.

Circumventing Tariffs and Trade Restrictions

Tariffs

The major risk that public companies face in connection with tariffs is that they might fail to record tariff-associated costs by manipulating or misrepresenting their supply chains.

For instance, companies might purchase finished goods or components, but misreport the country of origin as a low-tariff country instead of a high-tariff one in order to avoid recording the cost of tariffs. They could also falsely claim that suppliers of tariffed goods will cover some or all of the tariff costs.

Export Controls and Sanctions

In seeking to avoid the impact of sanctions or export controls, public companies could engage in various deceptive schemes, including:

- Manipulating the country to which restricted goods will be sold — for instance, with documentation stating a destination of Malaysia, when employees know goods are going to China;
- Misrepresenting the identity of the end customer;
- Misrepresenting the nature of the goods being shipped;
- Misrepresenting the end use of shipped goods;
- Circumventing controls designed to identify restricted parties;
- Circumventing controls designed to identify and classify products controlled under the Export Administration Regulations;
- Circumventing controls designed to assess export license requirements; and
- Failing to investigate third parties that have a high probability of export controls evasion, including distributors, resellers, agents and end users.

Concealment of Expenses, Costs and Losses Related to Tariffs or Trade Restrictions

Public companies also face risks with respect to manipulation of line items in their financial statements. These risks include manipulating estimated losses related to tariffs or sanctions, or failing to disclose or account for estimated fines, penalties or impacts incurred by illegal acts designed to evade U.S. sanctions and export laws.

Public companies might also fail to record proper amounts of charges for unusable inventory, including finished goods, raw materials and other components, or manipulate the timing of such charges from quarter to quarter, in order to meet earnings targets.

Inadequate Risk Factor Disclosures

Finally, public companies need to be both accurate and careful in how they describe the risks of the trade war, including potential or actual tariffs, for their business. The SEC has brought numerous cases penalizing issuers for downplaying such risks by treating them as hypothetical scenarios, when the actual risk has already transpired.[16]

Key Takeaways

Public companies need to be cognizant of the SEC's enforcement landscape with respect to financial reporting and disclosure risks, as well as sanctions and export regulations. The trade war presents multilayered risks regarding a public company's ability to manage the impact of tariffs and sanctions while providing truthful earnings guidance and protecting its profit margins.

The current SEC will likely scrutinize any public company deemed to be evading U.S. export and controls laws, or manipulating its financial statements, in order to conceal the impact of tariffs or sanctions.

Public companies need to ensure that their accounting practices and internal controls align with their public-facing disclosures, especially their critical accounting policies. When a financial reporting crisis occurs, the SEC will likely scrutinize closely how a public company discloses its accounting practices to investors. It is important to make sure that this road map is consistent — both externally and internally.

A robust compliance program will help mitigate risks. Public companies should ensure that they have strong compliance cultures, effective whistleblower channels, and effective policies and procedures to discourage risky behavior and escalate issues before they turn into crises.

They should also develop rigorous counterparty due diligence tools to ensure that they identify the ultimate beneficial owners of customers and other trading partners, as well as their countries of origin, in order to avoid even inadvertent violations of export control regulations or sanctions laws.

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[14] SEC Charges Retailer and Former CEO for Accounting, Reporting, and Control Failures, SEC.gov (July 21, 2021), https://www.sec.gov/newsroom/press-releases/2021-133.

[15] See, e.g., Quad/Graphics Inc.; RPM.

[16] In the cybersecurity context, the SEC has brought numerous cases against public companies for misleading cybersecurity risk factor disclosures where the company had reason to know a material cybersecurity incident occurred. See, e.g., SEC Charges Four Companies With Misleading Cyber Disclosures, SEC.gov (Oct. 22, 2024), https://www.sec.gov/newsroom/press-releases/2024-174.