Grant Thornton

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Webcast Teaser Video Transcript

Incorporating Uncertain Forecasts

So as Kendra mentioned, uncertainty was a theme at the conference this year. And that uncertainty can come from many directions related to major geopolitical events like the conflicts between Russia and Ukraine or Israel and Hamas, the impact of emerging technologies like GenAI, or the potential impact on the domestic and global economy of the incoming presidential administration's policies and including proposed tariffs. And this uncertainty makes its way into financial reporting as companies face real challenges in making the estimates that require consideration of forward-looking forecast where there's so much uncertainty about what those future periods are going to look like. So, Graham, can you walk us through how the accounting literature deals with some of this uncertainty for some common estimates?

Yeah, you bet Carolyn. So here on the right we have a non-exhaustive list of common accounting estimates that necessarily involve forecast forecasting, future events, circumstances or outcomes. And just to begin, the first step in making any accounting estimate is understanding the requirements and objectives of the estimate in the relevant accounting framework. For example, the current expected credit loss model applicable to financial assets security, amortized cost or as those of us who are financial instrument nerds lovingly refer to as Cecil, requires estimates of future economic conditions that drive credit losses in a company's investment portfolio. Whereas the impairment models for long lived assets and going concern assessments require forecast of future cash flows related either to a company's asset groups or to the company's whole. It's easy to see how the matters required to be forecasted under each of these accounting models could be impacted by the uncertainty that you described there, Carolyn.

Now on the left, we've depicted a way of thinking about making an accounting estimate. That is, first the company gathers the information that is relevant to the estimate and consistent with the objectives of and requirements of the accounting framework. Then the company designs a systematic process to develop an estimate that again is consistent with the objective of the accounting framework. And while most accounting estimates attempt to capture managers best estimate, others actually have a different objective, such as the fair value standard, whose measured objective is to be consistent with the views of a market participant, which may not necessarily be those of management.

Graham, that's really helpful, and I wanted to make 2 further points here. So first, companies often struggle with how to incorporate forecasts that have a high degree of uncertainty. So we'll take, for example, a company that believes that the current and forecasted rates of inflation are a critical input to its estimate, but it thinks that the future estimates of inflation are highly uncertain due to the timing and level of tariffs that might be imposed by the incoming presidential administration. So ignoring for a reasonable foreseeable future scenarios is generally not appropriate. Instead, companies often need to consider multiple future States and apply an appropriate probability waiting to those scenarios in their estimation process. Which brings me to my second point, which is the importance of a well-documented and controlled estimation process. We see many companies that are understandably worried about how their auditors or regulators will evaluate their judgments regarding what future scenarios waiting to incorporate in their estimation process. But the key is really for management to have a well-controlled, well documented and repeatable process to support their judgments.