# TMT insights: Financial reporting and accounting quarterly - Q1 2022

A PwC report on emerging trends affecting technology, media and telecommunications companies

In this first-quarter 2022 edition of *TMT insights: Financial reporting and accounting quarterly*, we spotlight the latest in environmental, social and governance (ESG). We take a look at the U.S. Securities and Exchange Commission (SEC) climate disclosure proposal that was recently issued as well as the establishment of a new international board that's likely to lay the groundwork for consistent and global reporting standards. We also consider the accounting and reporting implications of the Russian government's invasion of Ukraine. In addition, we dive into guidance regarding whether companies should report revenue on a gross or net basis and offer insight into what actions technology, media and telecommunications (TMT) companies should take now as the end of LIBOR draws near. For this and much more, including a roundup of new accounting and reporting standards effective in 2022, read on.

## Issue spotlight

The latest developments in ESG, including the newly proposed SEC rule that would require public companies to report the climate- related impact of their businesses.


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# Business update

The TMT industries have never been more complex, challenging or important as they are in today's world. TMT companies led a blistering, record-setting pace for IPOs, mergers and acquisitions and debt deals. We assessed the emerging themes from 2021 TMT deals and identified early indicators for what to expect for the remainder of 2022.

## Initial Public Offerings in TMT

In 2021, equity and debt markets showed an outstanding recovery from 2020, with the S&P 500 closing at record highs throughout the year. The US IPO markets set all-time records in both issuance volume and proceeds, with 951 IPOs raising $282 billion in 2021. Although this record-setting year was driven by outsized SPAC issuances, traditional IPOs also contributed by achieving the fifth-highest annual issuances in history. Led by software and e-commerce, there were 122 TMT IPOs during 2021, raising $68 billion in proceeds. This more than doubled the 59 TMT IPOs in 2020, which raised $37 billion.

Additionally, in 2021, SPACs raised $145 billion across 613 IPOs, the largest annual number of SPAC IPOs yet. There were 274 SPAC merger announcements — the majority in the tech sector — but there are still nearly 570 SPACs with $134 billion looking for deals within the next couple of years. Combined with private investment in public equity (PIPE) and debt, this could drive about a half-trillion dollars worth of M&A activity. SPACs attracted regulatory attention in 2021, with the SEC commenting on its desire to align SPAC disclosures and investor protections with a more traditional IPO process. SPAC merger dynamics in 2021 also included increasingly more difficult PIPE market conditions and dramatically rising redemption rates.

Following a record breaking year for the IPO market, 2022 is expected to be quieter with investors treading carefully as the IPO markets reopen, particularly taking into consideration a number of disappointing debuts that ended the year below their issue prices. We expect further broadening of the IPO sector pipeline as technology related and high-growth equity stories will be tested harder by investors, particularly around pricing, reflecting the share price downturn and headwinds of tech stocks in the second half of 2021.

## Mergers and acquisitions

The record jump in M&A activity is nowhere more evident than in TMT, specifically in tech. While the second half of 2021 has not matched the supercharged first half of the year, 2021 as a whole ended significantly higher than 2020 and well beyond pre-pandemic levels. During 2021, there were more than 16,000 TMT deals globally, a 32% volume increase over 2020. These deals were valued at $1.4 trillion, an increase of 48% in total deal value over 2020.

Emerging indicators from 2021 M&A activity reveal the likely M&A hotspots in TMT for 2022. As digital assets gain broader mainstream acceptance, traditional finance companies seeking a cryptocurrency foothold are bolstering their core businesses through M&A. Companies across industries are attempting to incorporate and monetize non-fungible tokens (NFTs) as a component of their core business. Tech-enabled health-care and wellness industries will continue to generate strong investor interest and high levels of M&A activity. We expect that advancements in artificial intelligence (AI)-enabled frontier technologies, data science and biotech will lead to a new generation of companies offering virtual visits, remote medicine delivery, personalized medicine, wellness and exercise equipment, wearables and

mental-health services. A focus on reducing carbon emissions stemming from COP26, the increasing importance of ESG reporting and government support for the energy transition are creating new market opportunities for companies focused on energy storage technologies. Companies developing AI, virtual reality (VR), augmented reality (AR) and connective hardware are attractive acquisition targets as interest in the metaverse grows, and we expect more M&A to quickly follow.

Dealmakers are optimistic that global TMT M&A activity will continue in 2022 amidst continued growth in the sector and a rapid pace of change. We expect momentum from 2021 to continue during 2022, fueled by available capital (from corporates, PE and SPACs) and by continued investor interest in content, crypto, digital assets and anything tech-related. Three areas to watch closely next year that could dampen M&A activity are rising interest rates, continued high multiples and a tightening regulatory environment—particularly in technology, as big tech players come under increasing scrutiny.

## Debt markets

US debt markets enjoyed another record-setting year in 2021. Both the high-yield (HY) bond and leveraged-loan (LL) markets set all-time issuance records. The markets were fueled by the government's fiscal stimulus, historically low interest rates, opportunistic refinancings and a boom in M&A and buyout deals.

The investment-grade market raised $1.37 trillion in 2021, a 19% decline from 2020's record-breaking year. The US HY bond market saw $465 billion in issuance and blew past 2020's record year, supported by a strong supply of M&A and buyout deals. The LL market set an annual record with $789 billion in issuance, a 100% increase from 2020. Leveraged buyout (LBO) and M&A activity accounted for more than 50% of the proceeds in the market, aided by pent-up demand for higher-returning investments. Issuers seized on historically low yields ahead of potential rate hikes. Bond yields saw a slight uptick in late 2021, but remain near all-time lows, as market participants price in the potential of three rate hikes in 2022 and the trajectory of the Fed's asset purchase tapering program.

The market will continue to debate the Fed's actions in 2022 as inflation, the potential for new Covid-19 variants, and evolving geopolitical concerns pose greater risks to the economy. The spike in inflation and the question of its longevity continue to add uncertainty around monetary policy. Additionally, M&A and LBO activities are expected to continue their pace and drive the market forward, as buyers compete for assets and corporations look for synergies and focus on their core operations.

# Accounting update

Recent geopolitical concerns continue to affect the global economy. In this issue, we consider the implications of the Russian government's invasion of Ukraine, including relevant accounting and financial reporting matters that may impact TMT companies. Further, we offer insight into principal versus net assessments and we round up new accounting standards for 2022.

## Implications of the Russian government's invasion of Ukraine

The world continues to focus on the recent events in Ukraine and the devastating impact they have had on the people in that region; their safety and well being continues to be the primary concern of all of us. The combination of the Russian government's invasion of Ukraine and the resultant sanctions—designed to inflict severe consequences on the Russian economy—has impacts not only to companies with operations in the region, but to all companies that participate in the global economy. The physical interruption of business operations has been compounded by economic sanctions imposed by the US and other governments, voluntary actions by businesses to cut ties with their Russian operations, and disruptions to commodity exports.

Our *In depth* article, Implications of the Russian government's invasion of Ukraine, highlights specific accounting and financial reporting matters that may impact companies, including those in the TMT sector, in the first quarter:

- **Disruption of operations** — e.g., impairments of assets located in, or dependent on operations in, the conflict zone.
- **Impact of Russian laws and regulations** — e.g., the impact to consolidation assessments for operations in Russia.
- **Exposure to customers affected by the conflict** — e.g., the impact to revenue recognition and increased credit losses related to receivables.
- **Supply chain disruptions** — e.g., the impact to the accounting for purchases and sales contracts.
- **Volatility in foreign currency and capital markets** — e.g., the impact to valuation and impairments of financial assets and liabilities.

Additionally, companies should be aware of a variety of other general reporting considerations related to the Russian government's invasion of Ukraine and related events. Companies that record pre-tax adjustments as a result of the conflict will also need to consider the tax effects as well as the impact of changes in operations on the estimated annual effective tax rate. Further, there are existing SEC requirements that may call for incremental disclosures related to the conflict in Ukraine in interim and annual SEC filings. Companies should also consider an assessment of subsequent events in this context.

Importantly, management should assess the need for transparent disclosure around the impact on current and future financial performance and the related risks and uncertainties. Timely company-specific disclosure is essential, even though it may be difficult to assess or predict the effects of the conflict with precision.

## Principal versus agent assessments in the spotlight

Determining whether to report revenue on a gross or net basis continues to be a challenging aspect of applying the revenue guidance. At December's AICPA & CIMA Conference on Current SEC and PCAOB Developments (the Conference), the SEC staff noted principal versus agent assessments as a frequent topic of consultation by registrants.

The issue arises when more than one party is involved in providing goods or services to a customer. A company that is the intermediary between two parties (e.g., a reseller, distributor, or platform) needs to assess whether it is the principal for the transfer of the good or service to the customer (gross reporting) or an agent arranging for another party to transfer the good or service (net reporting).

### How the guidance works

Principal versus agent assessments are a two-step approach: (1) identify each specified good or service that is being provided to the end consumer, and (2) assess whether the company controls each specified good or service before it is transferred to the end consumer. To help companies assess control, the guidance provides three indicators of control: (1) primary responsibility for fulfillment, (2) inventory risk, and (3) pricing discretion.

Assessing whether a company obtains control can be more challenging when a service or an intangible is being provided to the customer. In particular, transactions that involve multiple parties but occur in mere moments, such as a payment processing or internet advertising transaction, can be difficult to evaluate under the principal versus agent guidance.

### Key reminders

Principal versus agent assessments require a thorough understanding of the roles and responsibilities of each party involved. This includes evaluating both the contractual arrangements and the company's customary business practices. It's also important not to shortcut the steps of the model. For example, the assessment of control should be based on the control definition. The indicators should then be used to support that assessment rather than replace or override it, and certain indicators may be more relevant than others, depending on the fact pattern.

In some cases, a company may conclude that it integrates another party's good or service with its own goods or services into a combined offering provided to the customer. The SEC staff highlighted at the Conference that the company should consider the nature and significance of the integration service and whether it controls all inputs (including those provided by the other party) in order to integrate them. In other words, a company still needs to evaluate whether it obtains control of the other party's goods or services in this scenario.

Lastly, clear and transparent disclosures are critical to communicate the key judgments applied in the principal versus agent assessment and the conclusions the company has reached for its specific facts and circumstances.

For additional information, refer to Chapter 10 in our Revenue from contracts with customers guide and listen to our podcast, Principal or agent? Gross or net? Your revenue questions answered. Also, listen to our What you missed at the 2021 AICPA Conference podcast for more highlights.

## Making materiality assessments

On March 9, SEC Acting Chief Accountant Paul Munter issued a statement on how to consider materiality in the context of error corrections. Munter noted that the assessment of materiality should take a well-reasoned, holistic, objective approach from a reasonable investor's perspective based on the total mix of information, both quantitative and qualitative. He highlighted a need for increased objectivity and cautioned that the SEC staff has observed some materiality assessments that seem biased toward supporting an outcome that an error is not material. Need a refresher on this important topic? Revisit our recent podcast, Year-end toolkit: Making materiality assessments.

## Accounting standards effective in 2022

The start of a new year means adopting new accounting standards.There are multiple standards effective for public companies in 2022, including:

| Accounting standard | PwC resources |
|---|---|
| ASU 2020-06, *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40), Accounting for Convertible Instruments and Contracts in an Entity's Own Equity* | Financing transactions guide and our *In depth* articles, Adopting the new liability and equity guidance early and Accounting for convertible instruments and own equity contracts |
| ASU 2021-04, *Issuer's accounting for certain modifications or exchanges of freestanding equity-classified written call options* | Sections 8.3 of our *Financing transactions* guide and 7.4.1.6 of our *Financial statement presentation* guide |
| ASU 2021-05, *Lessors–Certain leases with variable lease payments* | Sections 4.3 and 10.10 of our *Leases* guide |
| ASU 2021-10, *Disclosures by business entities about government assistance* | Section 3.10.3 of our *Financial statement presentation* guide |

While not required in 2022, companies may choose to early adopt ASU 2021-08, *Accounting for contract assets and contract liabilities from contracts with customers*, which changes how revenue contracts acquired in a business combination are measured. For more information on this new standard, refer to our *In depth*, Accounting for acquired contract assets and contract liabilities.

For a refresher on the standards effective in 2022, listen to our podcast, FASB guidance effective in 2022. For a complete list of recently issued accounting standards and their effective dates, including links to PwC resources, refer to the Guidance effective for calendar year-end public companies and Guidance effective for calendar year-end nonpublic companies pages on Viewpoint.

# Regulatory update

TMT companies have an opportunity to influence the narrative with ESG reporting. Learn how recent regulatory actions have shaped the discussion around this important and evolving issue. Plus, learn about the SEC's proposals on cybersecurity—a top issue for CEOs, according to a recent PwC survey; what TMT companies can do to prepare for the end of LIBOR; and TMT SEC comment letter trends.

## SEC issues landmark climate disclosure proposal

On March 21, the SEC issued its highly anticipated proposal for new disclosures of climate-related information. The proposal would require most SEC registrants to provide specific disclosures in registration statements and periodic reports, such as on Form 10-K, about:

- climate-related risks and their actual or likely material impacts on the registrant's business, strategy and outlook;
- the governance of climate-related risks and relevant risk management processes;
- Scope 1 and 2 greenhouse gas (GHG) emissions (Scope 3 if material or if included in announced emission targets);
- certain climate-related financial statement metrics and related disclosures in a note to the audited financial statements; and
- information about climate-related targets and goals, if any.

The proposed rules would become effective in phases depending on the company's filer status. Large accelerated filers would be required to provide the new disclosures first in 2023 (Form 10-Ks filed in 2024), except information about Scope 3 GHG emissions, which would not be required until the following year. The proposal would also require accelerated and large accelerated filers to obtain an attestation report providing assurance over information about Scope 1 and 2 GHG emissions, also subject to phased-in compliance dates.

Comments are due 30 days after publication of the proposal in the Federal Register or May 20, whichever is later.

### Other ESG reporting updates

Outside of the US, the International Financial Reporting Standards (IFRS) Foundation Trustees announced late last year the creation of the International Sustainability Standards Board (ISSB). The ISSB will provide the foundation for consistent and global reporting standards that will enable companies to report on ESG factors affecting their business. In the EU, the European Financial Reporting Advisory Group (EFRAG) has begun releasing initial drafts of sustainability standards that are expected to become mandatory under the proposed Corporate Sustainability Reporting Directive (CSRD). For more information, read our In the loop publication, Make no mistake – global ESG regulations will impact US companies.

For TMT companies, the opportunity is significant to influence the ESG narrative, particularly since their products and services permeate other sectors and provide enabling capabilities. Stakeholders expect clear, standardized information on ESG risks and opportunities that affect the value of the business. For more on related challenges and potential solutions, read PwC's recent report, TMT stakeholders are asking questions: How to tell them a credible ESG story. Also consider a recent PwC survey of US investors on the economic realities of ESG. It found that investors may be the most vocal about the need for greater ESG transparency.

Not sure where to start on ESG reporting? Read our new series, beginning with ESG reporting: Getting started, where we walk you through ESG reporting, step by step. And, check out PwC US ESG Leader Casey Herman's article, Four actions to fast track ESG in 2022.

## Regulatory actions seek to enhance reporting and disclosures on cyber

Cyber risk remains front and center, particularly in the current geopolitical environment; CEOs continued to cite cyber risk as a top threat in PwC's 25th Annual Global CEO survey. On March 15, the Strengthening American Cybersecurity Act was signed into law requiring reporting of cybersecurity incidents by critical infrastructure entities and operators. The SEC has also issued multiple proposals related to cybersecurity in the first quarter, including a proposal in March to enhance public companies' disclosures related to cybersecurity. The proposed amendments would require:

- current reporting on Form 8-K about material cybersecurity incidents;
- periodic reporting to provide updates about previously reported cybersecurity incidents and disclosure of policies, procedures, and oversight regarding the identification and management of cybersecurity risks; and
- annual reporting about the cybersecurity expertise of the company's board of directors.

Comments are due 30 days after proposal publication in the Federal Register, or May 9, whichever is later.

See our In brief, SEC proposes new cybersecurity disclosure requirements, and join our Q1 2022 Quarterly accounting webcast with keynote speaker Sean Joyce, PwC's US and Global Cybersecurity and Privacy practice leader. You may also be interested in our new report Overseeing cyber risk: the board's role.

## The end of LIBOR draws near: What actions should TMT companies be taking?

The shift away from LIBOR to alternative reference rates is a significant change for the global financial markets. January 1 was a major milestone in this transition with the administrator to LIBOR ceasing publication of certain USD LIBOR and most non-USD LIBOR settings. Additionally, US banking agencies have directed banks to discontinue entering into new agreements referencing USD LIBOR, with some exceptions. Remaining USD LIBOR settings are expected to cease to exist beyond June 30, 2023.

Reference rate reform will impact all companies, including those in the TMT sector. A first step is identifying existing LIBOR exposures. Generally, non-financial institutions will have less volume of direct exposures than financial institutions, but some examples may include borrowings and derivative instruments. Arrangements with LIBOR exposure will need to be renegotiated, modified, or replaced prior to June 2023; therefore, finance teams should be prepared to react to these changes. Additionally, companies should not lose sight of the use of LIBOR in their systems and processes, sometimes referred to as indirect LIBOR exposure. For example, LIBOR is often used as a discount rate in valuation, which will require updates to models, systems, and processes to incorporate new rates, such as the Secured Overnight Financing Rate (SOFR). Systems and processes will also need to be updated to perform tasks such as calculating accruals for arrangements with new rates.

The SEC has continued to emphasize the importance of transparent disclosures about the impact of reference rate reform, most recently in a staff statement issued in December 2021. The SEC has encouraged companies to provide qualitative disclosure and, when material, quantitative disclosure, of the status of the company's transition efforts and the related risks.

The FASB issued ASC 848, Reference rate reform, to provide relief for the transition away from LIBOR. The guidance in ASC 848 has a current sunset date of December 31, 2022, at which time it will be superseded. In response to changes in the timeline of LIBOR transition, the FASB recently voted to propose an extension of the sunset date to December 31, 2024. An exposure draft is expected soon. For more information, read our Reference rate reform guide and listen to our podcast, LIBOR transition past, present, and future.

## TMT SEC comment letter trends

The SEC Division of Corporate Finance's filing review process is a key function used by the SEC staff to monitor critical accounting and disclosure decisions applied by registrants. Our analysis of SEC comment letters identifies the frequent topical areas addressed by the SEC staff and how their focus areas have changed over time. Read more on SEC comment letter trends for TMT companies, in which we provide insights on the nature of the SEC staff comments, sample text from the comments and provide links to sites where you can learn more about the accounting and disclosure requirements addressed in each area. Within the TMT sector, the top three areas of focus for the 12 months ended December 31, 2021 are:

- Non-GAAP measures — compliance with Item 10(e) of Regulation S-K and the related compliance and disclosure interpretations
- Segment reporting — how registrants have identified operating segments and aggregated them into reportable segments
- Revenue recognition — emphasis on the nature of performance obligations, why goods or services are distinct, how a company estimates variable consideration, the determination of standalone selling price, gross versus net presentation judgments, and disaggregated revenue disclosures

### Climate change

While the SEC considers new climate-related requirements for US public companies, in September the SEC's Division of Corporation Finance released example comments registrants may receive about their climate-related disclosures in the context of the existing disclosure framework. These examples include questions about the following, to the extent not currently addressed in disclosures:

- More expansive disclosure in the corporate social responsibility (CSR) report than provided in SEC filings
- Significant developments in legislation, regulation and international accords regarding climate change
- Indirect consequences of climate-related regulation or business trends
- Physical effects of climate change on the company's operations and results

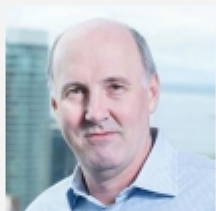
Stay tuned for our updates to the In the loop, Don't wait until the SEC staff asks you about climate change, to incorporate recent SEC comments on climate disclosures.

# About PwC's TMT industry practice

At PwC, our purpose is to build trust in society and solve important problems. Our TMT practice is dedicated to helping business leaders in the technology, media and telecommunications industries manage their complex businesses while delivering sustained outcomes. In doing so, we provide professional services across two segments: Trust Solutions and Consulting Solutions. Within these segments we bring a range of capabilities, including risk, transformation, cloud and digital, deals, ESG, cybersecurity and privacy, governance/boards, tax services and much more. Across our global network of more than 295,000 professionals in 156 countries, we are committed to advancing quality in everything we do.

# Let talk

For deeper insights on the content included in this edition of our TMT Accounting & Financial Reporting Insights, or to discuss other challenges, please reach out to any of our TMT leaders to discuss. We're here to help.



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