TMT sector game changers

A biannual report on new accounting and reporting trends—June 2020 edition

TMT sector game changers is a biannual report highlighting new accounting and reporting trends affecting the technology, media and telecommunications (TMT) industries, some of the most dynamic and competitive segments of today's economy. The report is designed to help you stay informed and ahead of the curve in an ever-changing marketplace.

In this edition, we highlight certain COVID-19 related hot topics, including considerations for returning employees to the workplace, valuation and impairment reminders, collectibility of receivables (CECL, or current expected credit losses), TMT sector trends in M&A and capital markets, and SEC comment letter trends.

Valuation reviews and reminders on impairment considerations

In an exceptionally short period of time, COVID-19 has had a major impact on the general economy, as well as in the financial and credit markets. With so much uncertainty, companies need to continue proactively assessing what this crisis means for the value of their assets, with impairment considerations being a focal point.

Given the uncertainty regarding the duration and severity of COVID-19 and its economic impacts, it is likely that companies will need to employ even more careful considerations and judgment as they work through impairment assessments.

Key inputs to valuation models, such as cash flow forecasts and/or inputs into the discount rates, are likely to change, especially in industries where there is likely to be a shift in demand or disruptions in supply chain, etc. Put simply, it will probably be an iterative process, as management works to reflect the risk and uncertainty in its cash flow forecasts and to determine an appropriate discount rate, given new facts and circumstances in the wake of COVID-19.

While preparers often focus on goodwill impairment in periods of economic challenge, it is equally important for companies to evaluate other assets that may be impaired, such as property, plant and equipment, other intangible assets, inventory, trade receivables, right of use assets under leases, and investments in debt and equity securities. Evaluating these assets—and ensuring that the appropriate basis is reflected in a company's financial statements—requires a well-coordinated effort with cross-functional expertise.

Spotlight on impairments of right-of-use assets

Under the new leasing guidance, ASC 842, lessees recognize virtually all leases on the balance sheet. As a result, the leased assets under operating leases, referred to as right-of-use assets, need to be evaluated for impairment. The relevant impairment guidance is in ASC 360, the same impairment guidance that is applied to other property, plant and equipment, including assets obtained under finance leases. Here are some reminders about impairments of right-of-use assets:

Revisiting the useful life of a lease asset

The useful life of a leased asset might need to be reconsidered when the leased asset is impaired, or when there are changes in how the asset will be used. In the same context, a company that plans to exit a leased space that it does not intend to sublet should also not presume that the lease asset has no future value.

Specifically, the company should reconsider the useful life of the asset based on its expected use, and also should determine what the expected fair value of the asset at the date of exit would be from a market participant's perspective. Depreciation for the remaining useful life should take into account the expected fair value of the asset at the time of exit.

When considering the useful life of leasehold improvements, a company should take into account its assumptions for the associated leased asset, as well as any intent to exit and/or sublease the space.

Inclusion of the lease liability in the asset group

The asset impairment test under ASC 360 requires comparing the carrying amount of the asset group to its expected undiscounted future cash flows, commonly known as the recoverability test. When performing the test, companies may elect to either include or exclude the lease liability from the asset group. Companies that exclude the liability should also exclude the associated rent expense from the expected future cash outflows. Conversely, those that include the liability in the asset group should also include the associated rent expense.

Companies that choose to include the associated rent expense could include either the entire rent expense in the expected cash flows or only the portion associated with repayment of the "principal" under the lease obligation. Regardless of whether a company elects to include or exclude the lease liability and associated rent expense, we believe that election is only applicable to the principal portion of "fixed" lease payments. Estimates of variable lease payments, that are not reflected in the lease liability, should always be included in the expected future cash outflows.

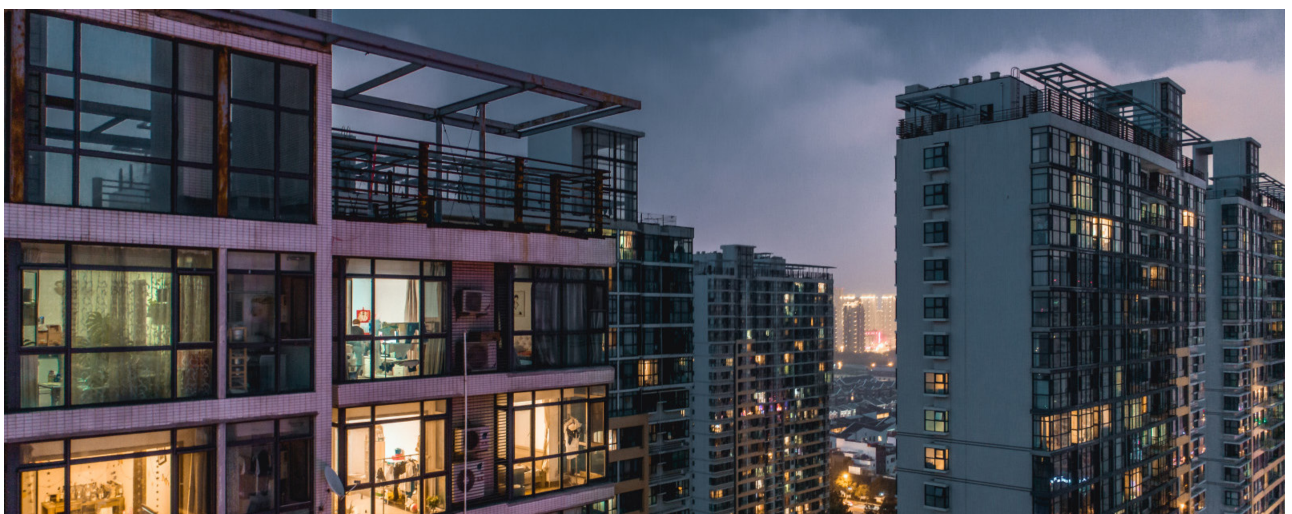
Exiting a floor in a building

While a company may initially view a leased building as a single right of use asset, each floor may meet the definition of a separate lease component under the leases guidance. Accordingly, if a company exits a floor, it may be appropriate to reevaluate whether there is more than one lease component and view the exited floor (or floors) as a lease component separate from the floors that continue to be occupied. Further, as companies may track the cash flows associated with the exited floor(s), they may be required to consider the exited floor (or floors) as a separate asset group for impairment purposes.

Lease assets accounted for as a portfolio

The new leases standard allows companies to account for leased assets with similar characteristics as a portfolio, provided that the result will not be materially different from the result if each lease were accounted for individually. Although the guidance allows using the portfolio approach for lease classification and initial measurement, the right-of-use assets should not necessarily be combined for the purpose of impairment testing. Rather, a company should consider the asset group in which each individual right-of-use asset should be included. Once a right-of-use asset under an operating lease is impaired, a lessee may no longer recognize expenses for that lease on a straight-line basis, but must calculate the lease expense in a manner similar to a finance lease.

For more information, please read *Leased Assets: Ongoing Impairment Considerations* and *COVID-19 Impact on Accounting for Valuation and Impairments*, or listen to our podcast series, including *COVID-19 impairment valuation questions answered*.



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 frequency of topical areas addressed by the SEC staff and how their focus areas have changed over time. Read more on SEC comment letter trends for technology, media and telecommunications companies, in which we provide insights on the nature of the SEC staff comments, sample text from the comments, and links to where you can learn more about the accounting and disclosure requirements addressed in each topical area.

SEC comment letter trends for technology, media and telecommunications companies

Current Period (4/1/2019 – 3/31/2020)*	Relative change in number of letters compared to the Prior Period*
Non-GAAP measures	↑
Revenue recognition	↓
Management's discussion and analysis	↑
Segment reporting	↑
Income taxes	↔
Disclosure controls and ICFR	↔
Form compliance and exhibits	↔
Accounting changes and error corrections	↔
Leases	↑
Goodwill and other intangibles	↓

*This analysis was performed based on topical areas assigned by research firm Audit Analytics for comment letters publicly issued in the 12 months ended March 31, 2020 ("Current Period") and the 12 months ended March 31, 2019 ("Prior Period") in relation to Form 10-K and Form 10-Q filings. Total comment letters evaluated during the Current Period and Prior Period were approximately 170 and 220, respectively.

Legend

↑ The relative number of comment letters has increased.

↓ The relative number of comment letters has decreased.

↔ The relative number of comment letters has not changed significantly.

Source: *TMT SEC Comment Letter Trends*, June 2020

Observations from comment letters

Non-GAAP financial measures result in frequent comments regarding compliance with Item 10(e) of Regulation S-K, sometimes resulting in requests to remove or substantially modify non-GAAP metrics. Focus areas include presentation of a non-GAAP measure with greater prominence than a GAAP measure or failure to reconcile the non-GAAP measure to the most directly comparable GAAP measure; appropriateness of adjustments to eliminate or smooth items identified as non-recurring, infrequent or unusual; use of individually tailored accounting principles; and disclosure of why management believes the non-GAAP presentation provides useful information to investors.

Revenue recognition topics that are most frequently addressed in the SEC staff's comments include the nature of performance obligations, why goods or services are distinct, and how a company estimates variable consideration; the timing of when control of a performance obligation transfers; gross versus net presentation judgments; and disaggregated revenue disclosures.

MD&A comments have emphasized the requirements in Item 303 of Regulation S-K and the related disclosure objectives. Most frequent topics include 1) discussion and analysis of results of operations, including the description and quantification of unusual or infrequent events or any significant economic changes; 2) metrics used by management in assessing performance, including how they are calculated and period-over-period comparisons; 3) critical accounting estimates, including the judgments made in the application of significant accounting policies, and the likelihood of materially different reported results if different assumptions or conditions were to prevail; and 4) liquidity and capital resources, including a clear discussion of drivers of cash flows, along with the trends and uncertainties related to meeting known or reasonably likely future cash requirements.

Are you responding to a comment letter? Read our best practices on The Comment Letter Process.

Also click here to read more observations related to TMT SEC Comment Letter Trends.

Collectibility of receivables and the new credit losses standard (CECL)

The extent of the impact of COVID-19 may be both direct and indirect, and it will vary based on a variety of facts and circumstances, including a company's industry, location, customer and supplier diversification, and the duration of the outbreak.

Given the current market conditions and concerns about the pandemic, accounting for the new expected credit loss standard may be particularly challenging from an accounting and reporting perspective for many companies.

CECL requires companies to consider current conditions and reasonable and supportable forecasts in developing an estimate of expected credit losses. This estimate requires the use of judgment, especially in times of economic uncertainty.

As a result of these changes, companies should update their models and estimates to reflect the revised economic outlooks, perform sensitivity analyses based on the new forecasts, adjust probability weighting on alternative scenarios, consider qualitative adjustments and/or provide additional disclosures.

Companies should consider the impact of current conditions and economic forecasts relating to specific sectors, geographical areas and customer-specific exposures. Companies should consider whether data used in its estimates (e.g., ratings or other indicators) reflect current conditions. Following a systematic and well-documented process consistent with the guidance in SEC Staff Accounting Bulletin No. 119 will continue to be important in developing the estimate for credit losses. In addition, it will be important for companies to provide transparent disclosures on the impact of the current economic environment, including assumptions used and their impact on the estimate for credit losses.

In this environment, it is important that management consider whether the models used to estimate credit losses are based on historical data and historical relationships during stable periods, as well as whether data used in developing the estimate is appropriately sensitive to current economic conditions. Management should also consider whether their model is sufficiently granular to specific industry sectors and geographies that may be impacted by COVID-19 differently.

Interplay with ASC 606

Management should consider the interplay between the judgments made under its CECL model and the judgments made around assessing whether collection is probable under ASC 606 for their revenue arrangements with customers. Additionally, in the current economic environment, companies may be experiencing concession requests from customers or otherwise offering "goodwill gestures" in the form of price concessions or extension of payment terms. As companies may be thinking about a plan to provide price concessions to customers, significant judgment may be required to estimate the variable consideration associated with the price concession plan. Providing additional time to customers to pay the agreed upon consideration should be considered in estimating the amount of consideration that is probable of collection both under the revenue standard and in the application of the credit losses standard. Companies who are extending payment terms beyond one year will also need to consider whether a significant financing component exists.

For more information, please read our *In Depth: FAQ on accounting for COVID-19 and market volatility* and listen to our podcast *COVID-19: CECL consideration questions answered*.

Effective date of upcoming accounting standards

Calendar year-end	PBEs	Nonpublic companies
2020	Cloud computing Collaborative arrangements Consolidation: VIE related party Credit losses (a) Defined benefit plan disclosure requirements Definition of collections Episodic television series Fair value measurement disclosure requirements Goodwill impairment (a) Reference rate reform Share-based consideration to a customer	Definition of collections Down round features Fair value measurement disclosure requirements Nonemployee share-based payments Not-for-profit entities: accounting for contributions Premium amortization on callable debt securities Reference rate reform Revenue (c) Share-based consideration to a customer
2021	Equity securities, equity method, and derivatives Simplifying accounting for income taxes	Cloud computing Collaborative arrangements Consolidation: VIE related party guidance Defined benefit plan disclosure requirements Episodic television series Hedging
2022	Insurance: long-duration contracts (b)	Equity securities, equity method, and derivatives Leases (c) Simplifying accounting for income taxes
2023		Credit losses (a) Goodwill impairment (a)
2024		Insurance: long-duration contracts (b)

a) Effective in 2020 for SEC filers other than SRCs; effective in 2023 for all other companies, including SRCs.

b) Effective in 2022 for SEC filers other than SRCs; effective in 2024 for all other companies, including SRCs. The FASB voted on 6/10/20 to propose a one year additional deferral which is expected to be finalized in the Fall.

c) On June 3, the FASB issued guidance (ASU 2020-05) that defers the effective dates of the revenue and leases standards (ASC 606 and ASC 842, respectively) for entities that have not yet issued financial statements adopting the standards. Early adoption is still permitted.

For further information on the new accounting guidance for public and nonpublic companies, including available PwC resources, refer to the Effective dates for new FASB guidance page on CFOdirect.

TMT deals, funding and IPO summary

TMT deals, IPOs, and debt offerings

The first half of 2020 saw record activity in the US bond markets, with the overall investment grade bonds markets raising more than a trillion dollars in the first 5 months of the year despite the impact of COVID-19. The TMT sectors are particularly active in the bond markets, with telecoms' large customer bases providing recurring cash flow, which is attractive to structured debt investors. The investment grade bond market for the TMT sector tripled for both issuances and proceeds raised in H1'20 from H1'19. In the first half of 2020, 36 TMT companies issued $161 billion in proceeds, while in H1'19, 16 TMT companies issued $51 billion. Investment grade TMT issuances yielded between 0.5%-5.0%.

The high yield bond market did not perform as well as the investment grade bond market, partly due to the lower credit ratings making it a little more difficult to attract investors in the high-risk COVID-19 environment. But still, companies drew down credit lines and secured as much cash as possible in order to ride out the impending reduction in economic activity. High yield bond market activity for H1'20 for the TMT sector remained in line with H1'19, with 22 companies issuing $18 billion in proceeds, despite the high yield bond market effectively shutting for the month of March due to COVID-19. In the first half of 2019, 16 TMT companies issued $21 billion in proceeds. As TMT companies looked to mitigate near-term loss of revenue and shore up liquidity concerns, use of proceeds for high yield bond issuances shifted; in H1'20, TMT companies used 27% of proceeds to refinance, as opposed to H1'19 when TMT companies used 8% of proceeds to refinance. High yield grade TMT issuances yielded 3.6%-12.1%.

Overall, the TMT sector exhibited strong activity in both the high yield and investment grade bond markets as companies searched for alternatives to equity issuances to mitigate liquidity concerns and deliver shareholder value.

Following a strong IPO year in 2019, US IPOs came to a halt as global economic uncertainty and market volatility flared in light of COVID-19. This slowdown affected the TMT sector as well. H1'20 saw just 13 IPOs raise $5.6 billion in the TMT sector, of which almost all were software companies, compared to 26 TMT IPOs that raised $18.7 billion in H1'19. H1'20 TMT issuance hit its lowest volume since 2016, and lowest proceeds raised since 2015. Issuers stayed on the sidelines through May, shelving near-term IPO ambitions and directing attention toward their core businesses.

As volatility retreated and valuations rose to pre-COVID levels, IPO markets reopened with 6 TMT IPOs in the first two weeks of June, nearly doubling the number of TMT pricings in the previous 5 months. Investor appetite and increased issuances are all positive indicators for the IPO market, and especially in the TMT sector, where the growth prospects for SaaS and platform-based software companies continue to receive strong venture capital interest on their way to an IPO. Issuers will closely monitor investor appetite for deals in the pipeline – focusing on comparable companies by size, profitability and business model.

For more information, please read *PwC MoneyTree Report 2020* and *PwC's Global IPO Watch Q1 2020.*

Source: *Thomson Reuters and Dealogic as of June 12, 2020.*

Returning to the workplace

What does returning to the workplace look like going forward?

As authorities in many US states continue to ease restrictions in order to gradually restart the US economy, companies are developing their own plans for a return to the workplace. Though work may never be the same again, here's what you can do now to help move your company and your employees move forward successfully.

PwC's COVID-19 CFO Pulse Survey revealed that almost two-thirds (64%) of CFOs say they're very confident they can provide a safe working environment, and many continue to take measures like implementing new safety protocols and reconfiguring workspaces to allow for social distancing.

When returning to the workplace, how confident are you in your company's ability to do the following? (Respondents who are "very confident".)

Meet cutomers' safety expectations

74%

Provide a safe working environment

64%

Retain critical talent

61%

Balance needs of all stakeholders

47%

Manage employee well-being and morale

47%

Build skills for the future

47%

Identify new revenue opportunities

34%

Source: PwC COVID-19 US CFO Pulse Survey
May 6, 2020: base of 288

Their efforts will be crucial to easing tension with employees who are concerned about workplace safety. In a recent PwC survey of US employees, 51% of those who have been forced to stop working or to work remotely (some 468 respondents) say the fear of getting sick at work would prevent them from returning to the workplace if their employer requested it tomorrow. What would make them feel more comfortable? More than half (56%) want their employers to provide personal protective equipment; 51% would need assurances that their employer would inform them immediately if a co-worker tested positive for the virus; and 51% want customers entering the workplace to follow basic safety and hygiene practices.

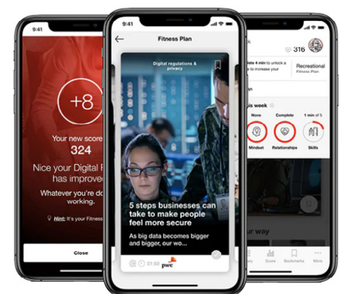
While developing your plan for a return to the workplace that addresses concerns shared by your workforce, consider the following:

Develop a plan to address and help mitigate workplace illness. As many employees head back to the workplace, they are likely to encounter others who have continued to work on-site as essential workers, as well as individuals who have different distancing practices. Understandably, this may concern returning workers. As you address workplace health and safety, include enterprise tools like Automatic Contact Tracing, which is geo-gated to the confines of your work facilities to help identify potential risks of exposure quickly, while also protecting privacy. Currently, 83% of companies do not have the processes and systems in place to track all of their workforce. PwC's Check-in tool consists of two products and is built with your people's privacy in mind. The products are **Status Connect**, which keeps you connected to your people and provides a near real-time view of their productivity, and **Automatic Contact Tracing**, which identifies your employees' risk exposure so leaders can quickly take action and to reduce risk of further exposure.

Determine who should return to the workplace. In a recent PwC survey, nearly half (49%) of companies said they were planning to make remote work a permanent option for roles that allow it. Confirm that your strategy addresses the needs of individuals who will work either on-site or remotely on a temporary or indefinite basis. (Here's a list of questions to ask yourself as you plan.)

Double down on automation and accelerate moves to digital. You've now seen first-hand which manual processes have stood in the way of operating efficiently, so improve or replace those processes. Speed up digital adoption, starting with technologies and processes that enable your employees to be more productive. Companies that already had been operating more digitally have been able to manage better during this crisis.

Consider PwC's Digital Fitness App as a way to boost your knowledge in topics that help shape behaviors, mindsets, relationships and skills. Learn at your own pace in a way that suits your style. You can watch, listen or read your way to digital fitness on topics such as artificial intelligence, blockchain, cybersecurity, robotics and virtual reality. Get the PwC Digital Fitness App free today from the Apple App Store or Google Play with the invite code "LRNALL."



For more resources as you consider your return-to-work plan, consider PwC's guide to returning to the workplace. For additional insights from PwC's COVID-19 CFO Pulse Survey, please visit to sign up for regular survey updates.

About PwC's TMT industry practice

PwC's TMT practice strives to help business leaders in the Technology, Media and Telecommunications industries manage their complex businesses and capitalize on new windows of opportunity. With offices in 158 countries and more than 250,000 people, we help organizations and individuals create the value they're looking for by delivering quality in assurance, tax, and advisory services.

Visit our website at: www.pwc.com/us/tmt

Let talk

For a deeper discussion on the content included in this edition of TMT Sector Game Changers or other challenges, please reach out to any of our TMT leaders to discuss. We're here to help.

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