TMT insights:

Financial reporting and accounting quarterly — Q2 2024

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

In this edition:

- TMT executives embrace innovative business models and data monetization.
- AI and emerging tech investments continue to rise, but so do ROI measurement and upskilling hurdles.
- M&A activity increases, with notable tech deals aimed at enhancing AI capabilities.
- Pillar Two became effective in January, and the upcoming IFRS 18 standard from the IASB will impact financial performance reporting.
- Challenges to the SEC climate rules are ongoing, but California's AB 1305 and other climate reporting requirements are here now.
- New rules abound, from the FTC's nullification of most non-compete clauses to SEC's new cybersecurity rules.

Issue spotlight

Stay ahead of the curve as we head into the third quarter of 2024 with updates on emerging tech impacts, deal trends, accounting guidance, Pillar Two and climate disclosure rules, and more.

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Business update

What's top of mind for TMT business leaders as we head into the third quarter of 2024? Meeting disruption with business reinvention. Despite a high-risk environment fraught with cyber attacks, regulatory headwinds and geopolitical uncertainty, their future outlook is optimistic.

Business model reinvention

In PwC's most recent **Pulse Survey**, TMT executives (93%) say their C-suite is unified in their vision for their company's future. And they've started to adopt or have already adopted innovative business models to bring that vision to life. Moreover, they're confident in their ability to execute business model changes at scale, and to use GenAI to make those changes.

One lever TMT leaders are pulling to develop new revenue streams is data monetization. However, 46% of sector executives say data monetization is one of the most significant transformation challenges they need to overcome. TMT organizations would do well to clear this hurdle, as data collaboration can create exciting new ways to provide value to customers, all while navigating customer expectations for data privacy and ensuring compliance with evolving and emerging data privacy regulations.

Investing in GenAI and emerging tech

AI investments continue to be a significant focus, according to PwC's Emerging Technology Survey, with 55% of TMT executives highlighting it as one of their top three investment priorities in the past 12 months. The adoption of generative AI (GenAI) capabilities has been critical to transforming internal operations and driving innovation, with nearly half (48%) of TMT companies reporting GenAI adoption in various areas of their business as part of their digital strategy. However, the adoption rates differ among subsectors.

GenAI is also being utilized to enhance procurement, streamline operations, automate customer inquiries and support, assist in software development — and, in the case of the video game industry, transform the value chain. In PwC's recent Digital Trends in Operations Survey, 46% of technology and telecom operations leaders expect GenAI to help their organization achieve continued operations efficiencies and 44% are already seeing cost savings.

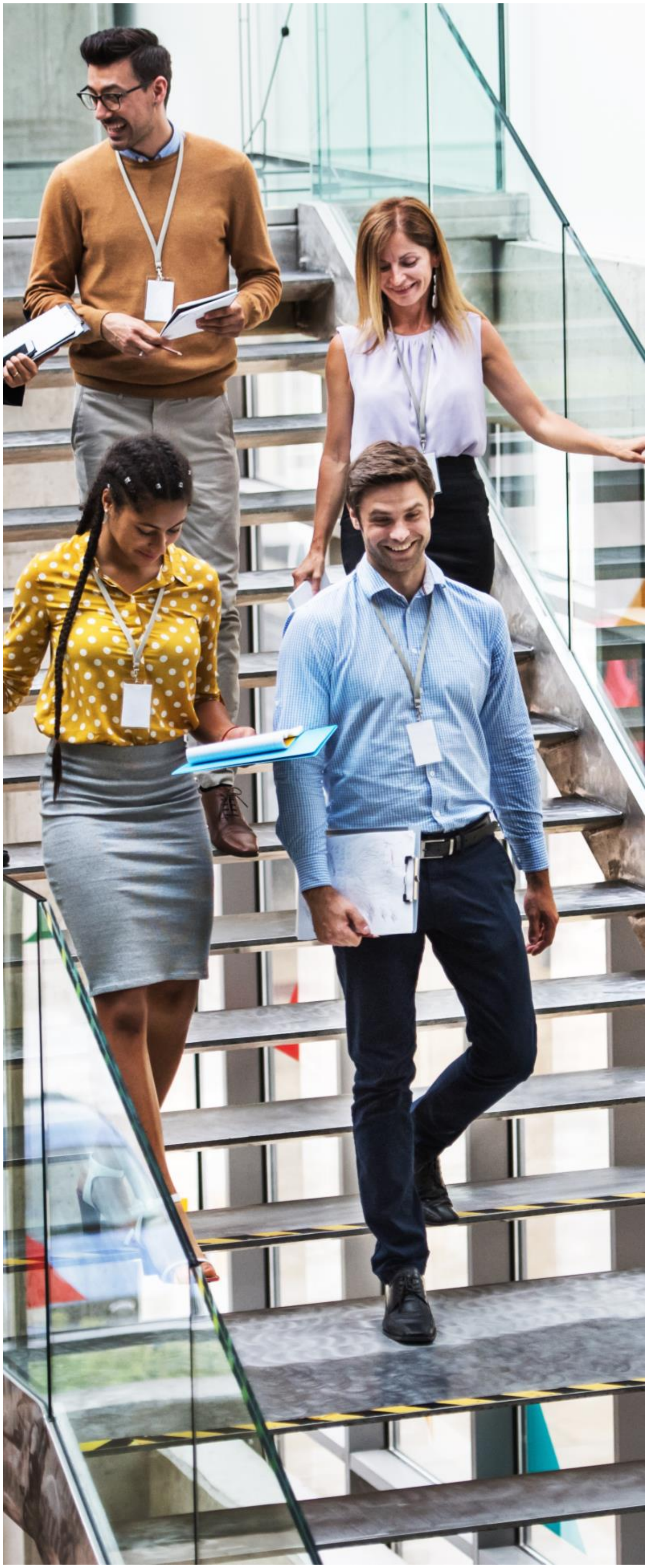
Considerable investments in emerging tech are being made despite the need to navigate significant external threats including industry disruption, lack of stakeholder trust in GenAI, cybersecurity, data privacy and reputational risk. Furthermore, certain investments in emerging tech are met with workforce resistance to change and are increasingly difficult to measure ROI. Some technology investments, however, are falling short: 75% of tech and telecom supply chain and operation leaders report that their technology investments haven't fully delivered the expected results. Despite disappointments, 51% of tech and telecom leaders increased their technology spend in the past year, indicating continued faith in the potential of emerging technologies. They're also investing in upskilling employees in the hopes that closing digital skill gaps may also help close the gap between expectations and ROI: 44% of tech companies and 71% of telecom companies increased their investment in technology-savvy talent including hiring, training and retraining employees.

Achieving growth through M&A

The continued buzz around AI's potential is also having an impact on M&A activity in the sector. For tech this meant a surge in megadeals, particularly in the semiconductor, networking, and cloud infrastructure industries. With a rise in deal volume and value in the first quarter of 2024, there's a clear appetite for innovation, as evidenced in examples like Cisco's massive $28 billion acquisition of Splunk and Synopsys' proposed $35 billion acquisition of Ansys. Many tech companies are on the hunt for ways to enhance their AI capabilities and private equity (PE) firms are also getting in on the action, leading deals to get a piece of the AI pie. The focus is on value creation and operational improvements, with an eye on an anticipated 2025 IPO window for potential exits.

Media and telecommunications are also seeing the impact of AI and an uptick in PE interest. Additionally, changes in consumer demands are leading to a boom in short-form, user-generated content platforms like TikTok, an evolution of streaming platforms, and a more significant role for AI in content creation. Notably, GenAI is revolutionizing the adtech market by reducing the cost and time needed to create new advertising campaigns.

Continued uncertainty around interest rates and global instability as well as regulatory scrutiny is still keeping the entire sector on their toes. And the 2024 US Election adds another layer of complexity as it could potentially shift the antitrust landscape. As we move forward, tech companies should stay ahead of technological trends, plan for election impacts and incorporate AI and other emerging tech into their due diligence processes.



Accounting update

In this issue, we highlight key considerations when assessing whether your contracts contain a lease, FAQs on Pillar Two tax legislation, and significant developments in international standard setting that could impact US companies.

Are leases hiding in your service or supply arrangements?

Leases embedded within a service or supply arrangement might get overlooked because, unlike a regular lease, the purpose of these transactions is to provide services or goods to a customer, not to allow for the use of an asset. In fact, the contract usually does not include the word “lease.” However, failing to identify an embedded lease can have significant accounting implications for both the supplier and the customer.

Assessing whether a contract contains a lease

A contract generally contains a lease when it conveys the right to control the use of a supplier’s physical asset to a customer.

Met conditions that result in contract containing a lease

Condition	Factors to consider
The supplier must use specific assets while fulfilling the contract. The contract might not identify those assets, but even if it does not, assets might be **implicitly identified.**	Examples of when a specified asset may exist include (1) the asset is physically on, or near, the customer’s premises, (2) the supplier is buying or building new assets to fulfill the contract, or (3) the supplier only has one set of assets that would be feasible to use to fulfill the contract.
The supplier does not have a substantive right to substitute the asset throughout the usage period. Substituting the asset due to maintenance should be ignored.	Even if the terms of the contract allow the supplier to substitute the asset, the right is not substantive if (1) the supplier does not have the practical ability to substitute, for example an alternative asset is not readily available, or (2) the supplier would not economically benefit from using the substitute asset.
The customer has the right to obtain substantially all of the economic benefits. Consider both primary outputs and by-products.	Assess whether the customer is contractually entitled to substantially all of the economic benefits. The assessment should also consider whether the supplier must obtain the customer’s permission to use the assets to serve other customers, or to use the output internally.
The customer directs how and for what purpose the asset is used throughout the period of use. Decisions made before or after the period of use (e.g., who designed the asset) should be ignored.	Consider decisions most relevant to changing how and for what purpose the asset will be used. Weight should be given to decisions that significantly impact the economic benefit that could be derived from the asset. Does the customer control most of those decisions?

It is often the last condition – whether a customer could “direct how and for what purpose an asset is used throughout the period of use” – that requires the most judgment. **Q & A examples: Possible indicators of meeting conditions for a lease**

Question	Examples
How?	Customer decides how the asset will be used (e.g., customer decides what to produce with the equipment, or decides whether to use a container for transportation or for storage).
When?	Customer controls when the asset will be used (e.g., a power generator is only used when the customer facility is open and it needs electricity; or, the customer may order goods or services “on demand;” that is, with such short lead time that the supplier has little discretion over the production schedule).
Where?	Customer controls **where** the asset is used (e.g., when portable, the customer may move the equipment from one floor to another).
Whether, or how much?	Customer decides **whether**, or **how much**, the asset will be used (e.g., the asset is idle when not in use).

Accounting implications of embedded leases

When the contract contains a lease, the arrangement is no longer simply a service or supply contract. For example, if a supply arrangement contains a lease, the customer is no longer purchasing products. The customer is leasing a piece of equipment and also hiring the supplier to operate and maintain the leased equipment on its behalf. The supplier, rather than selling products, is leasing equipment and providing contract labor and maintenance services. Both parties would recharacterize the arrangement from its contractual form and may have to allocate the consideration among the newly characterized lease and nonlease components. This allocation can be complex, particularly when the arrangement includes variable consideration.

To learn more, listen to our podcast, Identifying embedded leases in your contracts, and read chapter 2 of our Leases guide.

Pillar Two: Your frequently asked questions, answered

Pillar Two tax legislation has been implemented in over 35 countries, with certain provisions becoming effective as of January 1, 2024. The objective of Pillar Two is for large multinational enterprises to pay a minimum level of tax (a threshold effective tax rate of 15%) on the income arising in each jurisdiction where they operate. This global minimum tax brings significant complexity in determining impacts on the income tax provision for interim and annual financial reporting in calendar year 2024 for many multinational reporting entities. Read our publication, **Accounting for Pillar Two: Frequently asked questions**, for our insights on questions related to the implementation of Pillar Two, including interim considerations, valuation allowance impacts and more.

International standard-setting developments – what you need to know

In the first half of 2024, the International Accounting Standards Board (IASB) has issued a significant new standard on financial statement presentation and a proposal focused on disclosures about acquired businesses. Although US Generally Accepted Accounting Principles (GAAP) reporters will not be subject to these new requirements, US TMT companies may want to get up to speed on the changes as they could impact subsidiaries reporting under International Financial Reporting Standards (IFRS). Additionally, developments in international reporting can influence the perspectives of stakeholders and standard setters in the US.

New financial performance reporting requirements

In April, the IASB issued **[IFRS 18, Presentation and Disclosure in Financial Statements]**, introducing new requirements to improve the comparability of the financial performance of similar entities, with a focus on updates to the statement of profit or loss. The new standard will be effective beginning in 2027 for calendar year-end IFRS reporters and requires retrospective application. IFRS 18 includes three major areas of change:

Defined structure of the statement of profit or loss

- **Categories** – Items in the statement of profit or loss will be classified into categories. The three main categories are:
  - Operating – Includes: (1) results from main business activities and (2) income and expenses that are not classified in any of the other categories (i.e., the "residual" category).
  - Investing – Includes income and expenses from: (1) investments in associates, joint ventures and unconsolidated subsidiaries, (2) cash and cash equivalents, and (3) other assets that generate a return individually and largely independent of other resources.
  - Financing – Includes: (1) all income and expenses from liabilities that involve only the raising of finance (such as typical bank borrowings), and (2) interest expense and the effects of changes in interest rates from other liabilities (such as unwinding of the discount on a pension liability).
- **Required subtotals** – Entities will be required to present specified totals and subtotals, including "operating profit or loss," "profit or loss," and "profit or loss before financing and income taxes," with some exceptions.

Related disclosures

- **Management-defined performance measures** – IFRS 18 defines certain measures used by management that relate to financial performance as management-defined performance measures (MPMs). Information related to these measures shall be disclosed in a single footnote, including a reconciliation between the MPM and the most similar specified subtotal in IFRS Accounting Standards.
- **Disclosure of expenses by nature** – Expenses will be presented in the operating category by nature, function, or a mix of both. IFRS 18 includes guidance on determining the most appropriate approach. When items are presented by function, an entity is required to disclose information by nature for specific expenses (e.g., employee benefits, depreciation, amortization).

Aggregation and disaggregation

IFRS 18 provides enhanced guidance on the principles of aggregation and disaggregation, which are used in defining the line items presented in the primary financial statements and information disclosed in the notes.

Proposed amendments to improve reporting about acquisitions

In March, the IASB issued a proposal that would add new disclosures about a business combination in response to stakeholder concerns about the sufficiency of information about the performance of acquisitions and the challenges associated with goodwill impairment tests. The proposed disclosures would include:

- Information about the performance of business combinations, including acquisition-date key objectives and related targets for a strategic business combination and the extent to which those key objectives and related targets are met in subsequent periods, and
- Quantitative information about the synergies expected to arise from a business combination.

The proposal also includes targeted amendments to the impairment test for cash-generating units containing goodwill. Comments on the proposal are due July 15.

For more information

For more details regarding IFRS 18, refer to our publication, **IFRS 18 is here: redefining financial performance reporting**. Also, listen to our podcasts on IFRS 18 and the proposed disclosures for acquisitions.

FASB changes course on software costs project

Earlier this year, the Financial Accounting Standards Board (FASB) reconsidered the direction of its project on software costs after receiving feedback from stakeholders. After considering various approaches the FASB decided to pursue targeted improvements to the existing guidance for internal-use software in ASC 350-40. At its meeting in June, the FASB approved the issuance of proposed amendments to that guidance including:

- Providing factors to consider when evaluating whether it is probable a project will be completed (and thus, the capitalization threshold is met), focusing on software with significant development uncertainty (e.g., software with novel, unique, unproven functions and features or technological innovations)
- Removing references to stages of software development and,
- Requiring the same recognition guidance for all in-scope software regardless of the development process utilized (e.g., linear or nonlinear

The FASB also decided to require cash outflows for in-scope software costs (excluding implementation costs of hosting arrangements that are service contracts) to be presented separately as investing cash flows. Lastly, the FASB decided the proposed amendments would be applied on a prospective basis, with a retrospective option permitted.

The FASB directed the staff to draft a proposed ASU, which will have a 90-day comment period.

For the latest updates, refer to the FASB's project page.

Regulatory update

On the regulatory front, we provide updates on the SEC's climate rules as well as other sustainability reporting developments. We also highlight the FTC's new non-compete ban and the latest in SEC comment letter trends.

Developments in sustainability reporting

Last quarter, we reported on the U.S. Securities and Exchange Commission's (SEC) release of its final climate disclosure rules. Since then, as anticipated, legal challenges have been filed against the SEC by multiple parties. As a result, the SEC stayed its climate disclosure rules in April to "facilitate the orderly judicial resolution" of pending legal challenges. However, given ongoing interest from investors, and the overlapping nature of many of the sustainability reporting requirements worldwide, companies are encouraged to think holistically about the range of their sustainability reporting obligations. Systems, processes and controls should be developed that position a company to produce high-quality data in support of any current or emerging sustainability reporting responsibilities. Doing so will also position registrants for compliance with the SEC rules should the stay be lifted and the rules become effective. Below we cover other notable updates from the second quarter in sustainability reporting.

California climate disclosure bill

On January 1, California's AB 1305 became effective. The bill requires information about certain emissions claims and the sale and use of carbon offsets to be posted to a company's website. The definition of a "voluntary carbon offset" in the law is broad and includes instruments not typically referred to as such, including renewable energy credits and renewable identification numbers (related to renewable fuels) when used for voluntary purposes. February saw the introduction of another bill (AB 2331) that, if signed into law, would make it clear that renewable energy certificates issued through an accounting system of a governmental regulatory body or a low-carbon fuel standard credit are not in the scope of AB 1305. The same bill proposes to amend AB 1305 to require initial reporting on January 1, 2025. In May, the bill was approved in the State Assembly and awaits consideration in the State Senate.

Corporate Sustainability Reporting Directive (CSRD)

In April, the European Council approved a delay of the adoption of certain sector-specific and non-EU European Sustainability Reporting Standards (ESRS) by two years until June 2026. The approval only delays when the additional standards will be issued. It does not impact the timing of when companies are required to file their initial Corporate Sustainability Reporting Directive (CSRD) reporting using the sector agnostic standards that became law in December 2023.

In May, the European Financial Reporting Advisory Group (EFRAG) published (1) final ESRS implementation guidance related to the value chain and materiality assessments and (2) a compilation of new explanations to technical questions asked on the **EFRAG ESRS Q&A Platform**.

Announcement regarding international alignment

In May, the IFRS Foundation and EFRAG published guidance to illustrate the alignment between the IFRS Sustainability Disclosure Standards and the EU ESRS. The guidance (1) provides information on the alignment of climate disclosures and how to comply with both sets of standards, and (2) describes the alignment of general requirements of the two frameworks (e.g., materiality, presentation and disclosure of non-climate sustainability topics).

For more information

Refer to the first chapter of our new global **Sustainability reporting guidance** for help navigating the scope of US and global sustainability reporting frameworks. Stay tuned for additional chapters to be released throughout 2024.

Federal Trade Commission approves non-compete ban

In April, the Federal Trade Commission (FTC) approved a final rule that non-compete clauses are an unfair method of competition. Under the FTC's new rule, existing non-compete agreements with workers will no longer be enforceable after the rule's effective date of September 4, 2024. Existing non-compete agreements with senior executives (as defined by the rule) will continue to be enforceable. However, new non-competes cannot be created, except as it relates to non-compete arrangements between buyers and sellers of a business. TMT companies with intangible assets related to existing employee non-compete agreements should assess whether such agreements will cease to be enforceable upon the effective date of the rule and consider the impact to the useful life for such assets.

SEC clarifies voluntary reporting of cybersecurity incidents

In May, the Division of Corporation Finance released a statement clarifying the form and content of disclosures of cybersecurity incidents on Form 8-K. While a July 2023 rule requires disclosure of material cyber incidents on Item 1.05 (Material Cybersecurity Incidents) of Form 8-K, a company may elect to voluntarily disclose a cyber incident it has determined was not material or an incident for which it has not yet made a materiality determination. The statement encourages companies to make these voluntary disclosures under Item 8.01 (Other Events) of Form 8-K instead of Item 1.05. Then, if a company later concludes that the incident is material, it must file an Item 1.05 Form 8-K within four business days of that materiality determination. The statement also reminds companies of the factors that should be considered in the materiality assessment. For more on the disclosure rules, read **SEC adopts cybersecurity disclosure rules.**

For more on the materiality assessment for cyber incidents, read **Making materiality judgments in cybersecurity incident reporting**.

Trends in SEC enforcement actions

Enforcement actions are an important tool used by the SEC to advance its mission of protecting investors and promoting market integrity. In its fiscal year ended September 30, 2023, the SEC actively pursued close to 800 enforcement actions against individuals and corporations for violations of securities laws, which is a 12% increase over the past two years. The drivers of the violations spanned a range of topics including improper accounting, misleading disclosures and earnings manipulation. The SEC also continued its focus on emerging issues such as cybersecurity, crypto assets and ESG. Companies and boards may find it helpful to consider lessons learned from the past as they evaluate the effectiveness of their control environments and compliance programs. Read our publication, **Trends in SEC enforcement actions**, to learn more.

TMT SEC comment letter trends

The SEC Division of Corporate Finance's filing review process is a key function used by SEC staff to monitor critical accounting and disclosure decisions applied by registrants. PwC's analysis of SEC comment letters identifies frequent topics and how their focus has changed over time. For insights on the nature of the SEC staff comments, sample text from the comments, and links to sites where you can learn more about the accounting and disclosure requirements addressed in each area, see our publication: **SEC comment letter trends for TMT companies**.

Within the TMT sector, the top three areas of focus for the 12-months ending March 31, 2024, are:

- **Non-GAAP measures:** compliance with Item 10(e) of Regulation S-K and the related compliance and disclosure interpretations.
- **Management's discussion and analysis:** emphasizing requirements in Item 303 of Regulation S-K and the related disclosure objectives.
- **Revenue recognition:** continued SEC staff focus on gross vs. net presentation and identification of performance obligations, as well as judgments made in disaggregated revenue 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. With our global network of more than 328,000 professionals in 152 countries, we are committed to advancing quality in everything we do.

Let's talk

For deeper insights regarding the topics addressed in this latest edition of our **TMT insights: Financial reporting and accounting quarterly**, please contact:

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