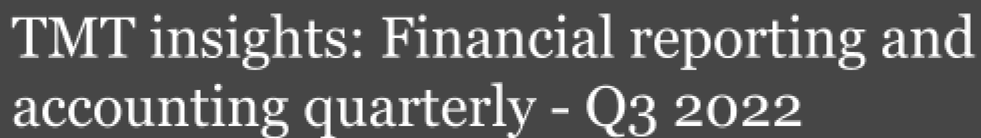

A PwC report on emerging trends affecting technology, media and telecommunications companies

In this edition:

- Learn how **macroeconomic trends are influencing IPOs** in the technology, media and telecommunication sector.
- Get the latest accounting update, including reminders about **assessing the realizability of deferred tax assets** and the latest **FASB news.**
- Read our regulatory update, which dives into **what's next for ESG reporting**.
- Plus, find out more about **new SEC disclosure rules involving executive compensation** as well as the top three TMT topics raised in **SEC comment letters.**

Issue spotlight

Get the trends continuing to drive TMT mergers and acquisitions, despite market volatility.

Plus, read the latest on financial reporting related to the Inflation Reduction Act and CHIPS Act.

- Business update
- Accounting update
- Regulatory update
- About PwC's TMT industry practice

Business update

The technology, media and telecommunications industries have never been more important as they are in today's ever-changing world. Through September, TMT companies broadly have experienced a significant decline in valuation. TMT IPOs have stalled, after reaching a record-setting pace in 2021. We looked at key macroeconomic factors affecting TMT companies.

Macroeconomic trends and IPOs

The US economy continues to experience persistent, high inflation and slowing growth, coupled with underlying pricing pressures, most notably with higher input and labor costs. This combination of macroeconomic trends has resulted in the longest extended period of high volatility since the 2008 financial crisis. The effect of this extended period of high volatility has continued to drive down TMT companies' valuations.

More than a third of CFOs consider a recession a serious risk to their company, and 71% think it's likely one will occur in the next 12 months, according to PwC's most recent Pulse Survey.

In September, the US Bureau of Labor Statistics released its Consumer Price Index Summary indicating a year-on-year inflation of 8.3%, which overshot previous estimates, leading many to expect continued interest-rate hikes from the Federal Reserve when it meets again in September. New increases would follow four previous interest-rate hikes in 2022. In both June and July, the Federal Reserve approved a 0.75% increase, the largest increases since 1994. These followed two earlier rate hikes of 0.25% in March and 0.50% in May. Federal Reserve Chairman Jerome Powell continues to signal further interest-rate increases are expected throughout the rest of the year as part of a continued effort to stem inflation.

Underlying supply chain pricing pressures and cost of labor continue to be the main sources of margin pressure for TMT companies. Labor demand remains strong, as there are still two jobs for every unemployed person. The realities of the Great Resignation, new working models and changing workforce expectations require attention. Our most recent Pulse Survey indicated that 55% of CFOs consider talent acquisition and retention to be a serious business risk.

However, persistent labor cost pressures driving margin compression have inspired transformation across TMT companies, including workforce optimization projects. Further, the Bureau of Labor Statistics has reported falling quit rates and job openings in recent months, indicating demand may be slowing.

Predicting when IPOs may rebound is challenging. In most cases, TMT companies planning such offerings have paused their efforts, given sustained market volatility is a significant impediment to pricing. This is particularly true for companies with late-stage investment at significantly higher valuations than those observed today. IHS Markit forecasts that growth in each of the TMT subsectors will slow from their strong year-over-year growth in 2021, returning to more normal, pre-COVID growth rates over the next five years.

Mergers and acquisitions

Despite increasing inflation, 2022 is set to be a strong year for dealmaking. Although continued disruptions of market volatility and geopolitical tensions are weighing on business' near-term outlook, some companies are seizing the opportunity to reshape their business. Companies are using this opportunity to reassess their portfolios against their core strategies to drive transformation that may potentially supercharge growth.

Trends driving investments from TMT companies throughout 2022 continue to be in emerging areas, such as **digital transformations** that allow companies to grow and operate more efficiently in a post-pandemic hybrid work environment. According to our Pulse Survey, 48% of CFOs plan to accelerate digital transformation initiatives to maintain or increase margins in the next 12 months.

Additionally, **cyber security** investments continue to trend. As cyber incidents are increasingly more complex and severe, companies are allocating more resources to address cyber risks to defend against attacks and to mitigate their impact.

While the **metaverse** remains in a nascent stage, it continues to attract significant investments from nearly all industries — notably gaming, employee experience and education.

Cloud capabilities are driving M&A activity with high demand across all industries for pre-built cloud tools, cloud services, applications and data/analytics managed services. Data analytics continues to draw investment interest as, according to our Pulse Survey, 47% of CFOs say their top priority is building predictive models and scenario analysis capabilities.

Read more insights in our publication What's important to CFOs in 2022.

Accounting update

In this issue, we take a closer look at the provisions of the Inflation Reduction Act and the CHIPS Act, including potential financial reporting implications for TMT companies. We also highlight considerations for assessing realizability of deferred tax assets. On the standard-setting front, FASB has added a new project on software costs to its agenda and voted to issue a proposal that would amend the segment disclosure requirements.

Inflation Reduction Act and CHIPS Act: What you need to know for financial reporting

In August, President Biden signed the Inflation Reduction Act (the IRA) and Creating Helpful Incentives to Produce Semiconductors (CHIPS) Act into law, which include a wide range of tax, clean energy and health-care-related provisions. Key aspects of the new legislation with potential accounting implications include a new corporate alternative minimum tax, an excise tax on stock buybacks, and significant incentives for energy and climate initiatives. Under US GAAP, changes in income tax rates and law are accounted for in the period of enactment. For US federal purposes, this is the date the President signs the bill into law although the majority of the provisions in the IRA and CHIPS Act will only impact financial statements prospectively.

Corporate alternative minimum tax

For tax years beginning after December 31, 2022, the IRA creates a 15% corporate alternative minimum tax (CAMT) on corporations with average annual adjusted financial statement income over a three-year period in excess of $1 billion. There are special rules for companies with a non-US parent that include an additional test to determine whether the company is subject to the CAMT. Companies that pay the tax will receive a non-expiring tax credit carryforward that can be claimed against regular tax in future years. ASC 740, *Income taxes*, requires deferred taxes to be measured using the regular tax rate even if a company anticipates being subject to the CAMT in the future. However, companies that expect to pay CAMT for the foreseeable future may need to reassess their valuation allowances in the period that includes the enactment date since certain existing deferred tax assets may no longer provide a future benefit under the CAMT regime.

Excise tax

The IRA imposes a nondeductible 1% excise tax on a publicly traded corporation for the value of certain stock that it repurchases (net of issuances), effective for repurchases after December 31, 2022. Because the excise tax is levied on a gross amount, its effects are not expected to be included in the income tax provision under ASC 740. We believe that it would be acceptable to consider the excise tax as a direct and incremental cost that is associated with the transaction that created it. Under US GAAP, many stock repurchases are accounted for as equity transactions with no income statement consequence, although certain equity transactions may have income statement consequences and not all shares of stock are classified as equity instruments. As a result, the accounting treatment for a stock buyback transaction may be relevant in determining the appropriate accounting for the excise tax.

Climate and clean energy initiatives

The IRA includes significant extensions, expansions, and enhancements of numerous energy-related tax credits and also creates new credits. Certain of the credits have a "direct-pay" election, which allows an eligible taxpayer to receive a current benefit from the credit without taxable income or a tax liability, while others provide for an election to transfer (i.e., sell) certain credits to another taxpayer.

The application of ASC 740 is warranted if a credit can only be claimed on the tax return and realized through the existence of taxable income. When a company is able to receive the benefit of a credit regardless of whether it has income taxes payable or taxable income, we believe the benefit should be accounted for outside of the income tax model. This would apply to credits with a direct-pay option. For credits with transferability provisions, if the company does not intend to transfer the credit, and will only realize its benefit by reducing income tax payable, it would account for the benefit of the credit as part of its income tax provision determined under ASC 740. However, if the company intends to realize the benefit of the credit by transferring it to another party, it should account for the credit outside of the income tax line. Companies will need to determine the appropriate accounting framework to apply to these credits, which may be akin to a government grant.

CHIPS Act

The CHIPS Act provides a credit of 25% of an eligible taxpayer's qualified investment in an advanced manufacturing facility. Similar to certain of the energy credits in the IRA, a taxpayer may make an irrevocable election to treat the credit as a payment against tax, thus electing the direct-pay option. Similar to the IRA credits discussed above, because this credit is refundable to the taxpayer even if the taxpayer does not have taxable income or a tax liability, it is more akin to a government grant and should therefore be accounted for outside of the income tax provision.

For more information

Learn more by reading our In depth, *Accounting for the Inflation Reduction Act and the CHIPS Act*, and listening to our podcast, *ESG incentives in the Inflation Reduction Act*.

Key reminders when assessing the realizability of deferred tax assets

The challenges of the current economic environment have put additional focus on the assessment of the realizability of deferred tax assets and the adequacy of the related valuation allowance, not only at year end but also during interim reporting periods. In some circumstances, this assessment can require significant judgment and a detailed analysis of the supporting evidence, so it's a topic to address early in the close process. We summarize some of the key considerations below.

Evidence to consider in the analysis

When assessing the realizability of deferred tax assets, the income tax accounting standard requires consideration of four sources of future taxable income:

- Taxable income in prior carryback years

- Future reversals of existing taxable temporary differences
- Tax planning strategies
- Projections of future taxable income

All available evidence — both positive and negative — must be considered, including operating results and trends in recent years. Companies should assign the most weight to the evidence that can be objectively verified. This means that what has already occurred (and thus can be objectively verified) carries more weight than what *may* occur. For example, projections of future income are not typically objectively verifiable.

Cumulative profitability or losses for the last three years is a significant factor when assessing the realizability of deferred tax assets. When considering historical results, it is often difficult to justify excluding items from prior periods under an assumption they will be “nonrecurring” given that events that have already occurred are typically the most objectively verifiable. Additionally, the absence of cumulative losses does not automatically result in the presumption of realizability of an entity's deferred tax assets.

It may be necessary to schedule out the future expected reversals of deferred tax assets and liabilities, if needed as support for realizability. This can be a complex exercise; therefore, it is important not to leave this aspect of the analysis to the last minute.

Other considerations

As a result of the 2017 Tax Cuts and Jobs Act, the calculation used to determine the interest expense deduction limitation for tax years beginning after December 31, 2021 is defined similarly to EBIT (earnings before interest and taxes) instead of the previously used EBITDA (earnings before interest, taxes, depreciation and amortization). The combination of this change and rising interest rates may result in larger deferred tax asset balances related to interest expense deduction carryforwards that will need to be assessed for realizability.

Lastly, don’t forget that subsequent events can also impact the analysis. Companies should carefully evaluate events that occur after the balance sheet date but before the financial statements are issued for any potential impact to their valuation allowance assessments.

For more information

For more details, see Chapter 5 of our *Income taxes* guide and listen to our tax toolkit: *Valuation allowances, weighing the evidence* podcast.

FASB looks to modernize guidance on software costs

The accounting for costs to acquire or develop software has become increasingly relevant across all industries as companies invest in technology and digital transformation. In June, the FASB added a project on software costs to its agenda, with a focus on modernizing the guidance and increasing transparency.

In the current guidance, there are different accounting models for (a) software used for internal use only (including software used to provide cloud-based services) and (b) software externally marketed to

customers. This can result in significant differences in financial reporting depending on the model that applies. Although the FASB has not yet made any decisions, some Board members expressed interest in exploring an approach that would provide a single accounting model for all software costs.

For more information, refer to the FASB's project page. To learn more about the current guidance, refer to our *Software costs* guide and listen to our podcast, *Buying or developing new software? Know which guidance to use*.

FASB votes to move forward with segment reporting proposal

At its July 27 meeting, the FASB voted to issue a proposal that would amend the segment disclosure requirements. The proposal would add new disclosures of significant segment expenses that are both (1) regularly provided to the chief operating decision maker (CODM) and (2) included in the reported measure of segment profit or loss. Significant segment expense categories would include those that are "easily computable" from the management reports that are regularly provided to the CODM. The FASB also decided to require disclosure of the title and position of the CODM, and to permit companies to report multiple measures of a segment's profit or loss. The disclosures would be required in both interim and annual periods and would also apply to companies with a single reportable segment. The proposal will have a 75-day comment period.

Regulatory update

On the regulatory front, comment periods have closed for a variety of domestic and international proposals on ESG related disclosures. We look ahead to the next steps in the process and highlight actions companies may need to take now to prepare for climate reporting. We also take a closer look at the SEC's recently finalized rules on executive compensation disclosures that may impact your next proxy. Plus, learn about the most recent trends in SEC comment letters for TMT companies.

ESG reporting: What's next?

The comment periods have now closed for the SEC's climate disclosures proposal, the International Sustainability Standards Board (ISSB) exposure drafts on general sustainability and climate disclosures, and the European Financial Reporting Advisory Group (EFRAG) exposure drafts on disclosures impacting a broad range of environmental, social, and governance matters. Looking forward, we expect a final rule from the SEC as soon as the fourth quarter and final standards from the ISSB in early 2023. EFRAG is expected to submit its standards to the European Commission later this year, beginning a process that will be finalized in mid-2023.

Companies that may be in the scope of one or more of these disclosures should not wait for the final rules. Practical considerations, such as identifying participants and leadership for a cross-functional team and determining the scope, data requirements, and related gaps, are steps that can be started now. At a minimum the following steps will help you hit the ground running when the final guidance is issued:

Evaluating what actions you should be taking now begins with determining the applicable ESG disclosure frameworks, which will determine timing and what information is required. This may sound simple, but there can be complexities:

- **SEC climate disclosure proposal:** As currently proposed, the rules would be applicable to domestic registrants and foreign private issuers, with limited exceptions. Proposed disclosure requirements are expected to be effective on a phased basis dependent on filer status, with some requirements not applicable to certain companies (e.g., GHG scope 3 emissions would not be required for smaller reporting companies). The requirements may be applicable as early as 2023 for large accelerated filers. Read our In the loop, *The SEC wants me to disclose what?*, for more details.

- **EFRAG exposure drafts:** The scope of the CSRD includes US and other non-EU parent companies with EU subsidiaries. In addition to subsidiary or EU-level reporting, some non-EU parent companies will need to report at the global consolidated level. The directive would apply to all companies listed on EU-regulated markets and "large," as defined in the directive, unlisted companies or groups in the EU. For some entities, disclosure and attestation requirements would be applicable as soon as 2024. Read our In the loop, *What's CSRD? You should already know*, for more details.

- **ISSB exposure drafts:** Individual jurisdictions will have to decide whether to require or permit application of ISSB standards as a basis for sustainability reporting, akin to the process for adopting IFRS accounting standards for financial reporting. Although there is a lot of interest in the ISSB standards, it remains to be seen which jurisdictions will adopt them once finalized. Read our In depth, *What you need to know about the ISSB Exposure Drafts*, for more details.

For a comparison of the "big three" disclosure proposals, read our In the loop, *Navigating the ESG landscape*.

SEC adopts pay versus performance disclosure rules

On August 25, the SEC adopted final rules that require enhanced disclosures related to executive compensation in proxy and information statements for many registrants, as mandated by the Dodd-Frank Act. For impacted calendar year-end registrants, the new rules will require incremental disclosures in proxy statements for 2022.

The rules amend Item 402 of Regulation S-K and apply to all registrants, other than foreign private issuers, registered investment companies, and emerging growth companies. Under the new rules, registrants will be required to provide incremental disclosures that depict the relationship between executive compensation actually paid and the financial performance of the registrant. Smaller reporting companies (SRCs) will be permitted to provide scaled disclosures.

Summary of the new disclosures

In a new table, registrants subject to the rules will need to disclose total compensation for the principal executive officer (PEO) and the average for the other named executive officers (NEOs) for the five most recent fiscal years. The table must include both the total compensation included in the Summary Compensation Table (currently required under Item 402) and executive compensation actually paid as defined in the rule. Further, the table must show the following measures of financial performance:

- Total shareholder return (TSR) for the registrant
- TSR for the registrant's peer group
- The registrant's net income
- A "company selected measure" – a measure selected by and specific to the registrant that represents the most important financial performance measure used for the most recent fiscal year to link NEO compensation actually paid to company performance.

In addition to the new table, registrants will be required to describe the relationship between (a) the executive compensation actually paid to the PEO and the average executive compensation actually paid to the other NEOs and (b) the financial performance measures, as disclosed in the table. The discussion must also include a comparison of the TSR of the company to the peer group TSR. Registrants will also need to provide three to seven performance measures it determines are its most important financial performance measures used to link executive compensation to company performance during the most recent fiscal year, which may also include non-financial performance measures.

SRCs are not required to disclose a peer group TSR, a company-selected measure, or financial performance measures. Additionally, SRCs are only required to provide the disclosures for the three most recent fiscal years.

Effective date and transition

The new disclosures are required in proxy or information statements that include Item 402 executive compensation disclosures for fiscal years ending on or after December 16, 2022. Three years of information is required in the initial year of adoption, with an additional year added in each of the two subsequent annual filings. SRCs may provide two years in the initial year of adoption, with a third year added in the subsequent year.

For more information

Find more details in our In brief, *SEC adopts pay versus performance disclosure rules*.

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. Our analysis of SEC comment letters identifies frequent topics and how their focus has 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 ending June 30 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
- **Segment reporting:** how registrants have identified operating segments and aggregated them into reportable segments

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 327,000 professionals in 155 countries, we are committed to advancing quality in everything we do.

Let's 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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