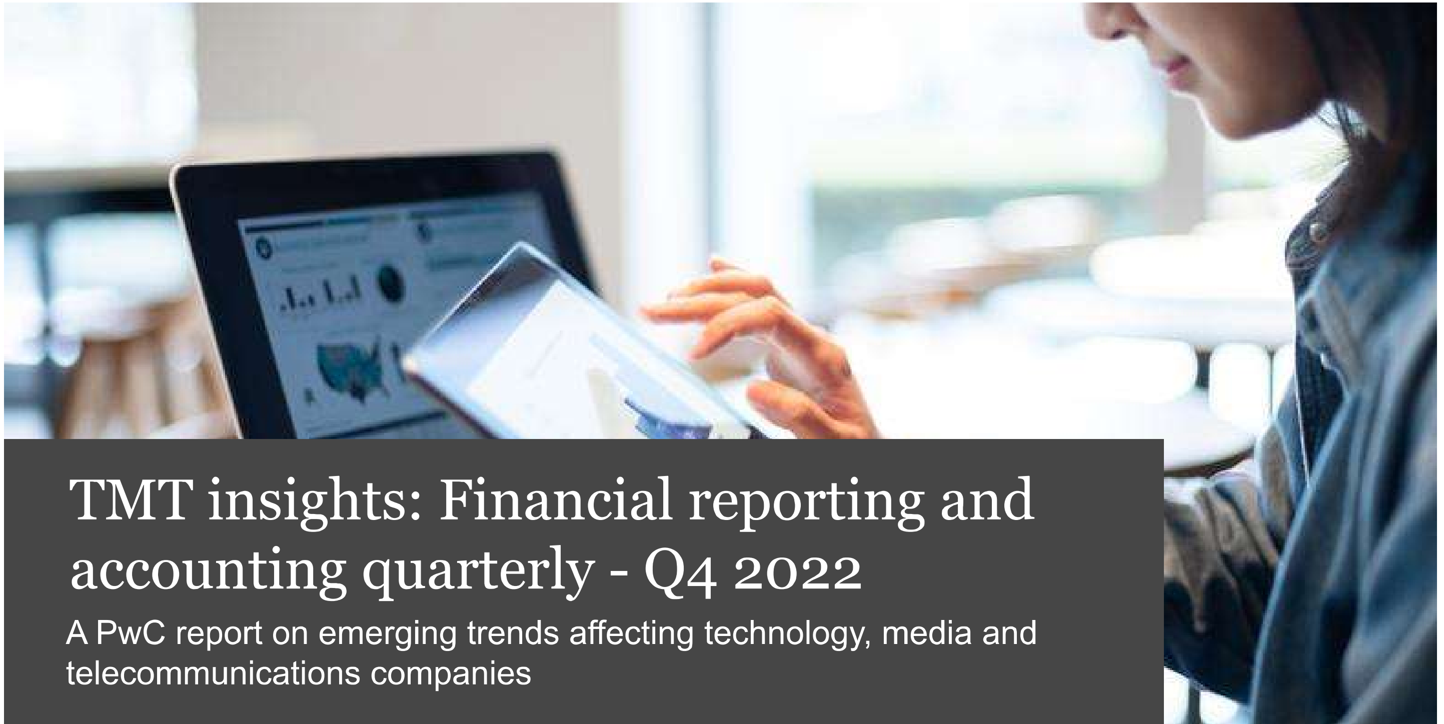

# TMT insights: Financial reporting and accounting quarterly - Q4 2022

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

In this edition:

- Learn how the **economic winds are chilling mergers and acquisitions** (M&A) in the technology, media and telecommunication (TMT) sector.
- Get the latest accounting update, including **top year-end reporting reminders**, implications of **workforce reductions** and **transferable credits provided by the Inflation Reduction Act (IRA)**.
- Read our regulatory update, which dives into **final rules for clawbacks of erroneously awarded executive compensation**.
- Plus, find out more about the latest in **Environmental, Social and Governance (ESG) reporting** and what you need to know about the **Organisation for Economic Co-operation and Development (OECD) minimum tax**.

## Issue spotlight

Find out how TMT deals fared in 2022 and what the outlook is for next year.

Plus, prepare for year-end accounting.


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

# Business update

At the onset of the COVID-19 pandemic, the world witnessed an unprecedented migration toward online activity and a surge of e-commerce, which resulted in supercharged technology growth rates and valuations. Low interest rates fed a frenzy of activity in the tech sector in 2021 and the first half of 2022, as companies with potentially transformative business models but uncertain future earnings offered a compelling value proposition to investors.

That trend has now reversed, and tech valuations have declined precipitously. With the Federal Reserve signaling that interest rates may remain high for the foreseeable future, the rise in the opportunity cost of capital on a risk-adjusted basis has caused technology companies to pivot from “growth at all costs” to a focus on profitability and positive cash flows.

## TMT Deals

While the first half of 2022 continued a banner run for technologyM&A, tech deals activity plummeted in the second half of the year. Buyers and sellers struggled to come to terms with an uncertain dealmaking environment, given a reset in valuations and the impact of broader macroeconomic conditions — primarily inflationary pressures, tightening monetary policy and corporate restructuring. As broader sentiment shifted, deal value declined 60% in the third quarter of 2022.

As we look toward the future, valuation pressure and macroeconomic challenges are expected to continue providing headwinds to the deal market. Private equity firms are sitting on substantial dry powder, but rising interest rates and a scarcity of available debt financing have tested the ability of private equity firms to sustain their recent level of dealmaking. As valuations continue to compress, we expect private equity firms to continue to pick up fallen unicorns and de-SPACs, which will provide potential opportunities for an increase in take-private transactions in 2023.

Looking ahead to 2023, we expect deal size and the level of mega deals to continue to decrease as liquidity remains tight and financing options stay limited. There are numerous opportunities for buyers to capitalize on valuation resets and potentially bolster their business with complementary technologies, workforce and competencies — all at potentially historical bargain prices. While dealmakers will need to be discerning and scrupulous in their diligence, we anticipate an uptick in deals activity in 2023, particularly in divestitures, take-private transactions and transformative acquisitions.

## IPOs

The de-SPAC and Tech IPO markets have also felt the broader chill of the equity markets. The last domestic issuer tech IPO was in January — a drought that lasted more than 300 days. Despite that, tech companies are beginning to pick up the pen on IPO preparation and public company readiness, particularly those held by private-equity firms. Companies want to be well-positioned and to be ready if and when the markets rebound. They are laying the groundwork early for successful IPOs by hiring advisors and assessing gaps in systems, processes and staff.

We expect to see additional tech companies test the capital markets in 2023, potentially with smaller initial offering sizes that are priced aggressively with deeper IPO discounts to entice investors. While 2022 was a tough year, we expect to see more tech IPOs next year, particularly in the second half of 2023 into early 2024.

Read more insights in our publication Technology: US Deals 2023 outlook and Media and telecommunications: US Deals 2023 outlook

# Accounting update

In this issue, we highlight key year-end financial reporting reminders for TMT companies. We also take a closer look at the accounting considerations for workforce reductions and other restructuring activities, and provide an update on the accounting for transferable credits provided by the Inflation Reduction Act. On the standard-setting front, the Financial Accounting Standards Board (FASB) has issued new proposals on segment reporting and common control leases, and voted to issue an exposure draft proposing new income tax disclosures.

## Top year-end financial reporting reminders

In the fourth quarter, many TMT companies are turning their attention to the year-end financial reporting season. Here are a few key topics that should be top of mind this year end:

### Management's discussion and analysis (MD&A)

Current economic factors — such as inflation, rising interest rates and supply chain disruptions — can impact a company's business in various ways. In response, management should be taking a fresh look at their disclosures. In particular, public companies should consider relevant disclosure within MD&A, including critical accounting estimates and liquidity, along with risk factors. As a reminder, MD&A should provide information that the company believes is necessary to explain its results, including known material events, trends and uncertainties impacting the business.

In our latest review of the US Securities and Exchange Commission's (SEC's) comment letter trends for TMT companies, MD&A was one of the most frequent areas of comment. Topics included short- and long-term liquidity needs, known trends and uncertainties, and impacts of current economic factors. Our podcast series on comment letter trends, including the episode on MD&A, provides helpful reminders for companies as they draft year-end disclosures.

### Asset impairments

The same current economic factors can also impact asset impairments and valuations. For example, management should consider the impact of inflation and supply chain disruptions on future cash flows, as well as the impact of rising interest rates on discount rates. Additionally, SEC guidance in Regulation S-K, Item 303, requires a sensitivity analysis of significant inputs as part of a company's critical accounting estimate disclosures. Companies should ensure they have effective controls over the models, data and key assumptions used in impairment analyses and related disclosures.
Our Impairment toolkit podcast series takes a deeper dive into impairment considerations in today's environment. Companies may also want to revisit our In depth *FAQ on accounting in uncertain economic times* for insights on a broad range of accounting considerations related to the current economic environment.

### New disclosure requirements for 2022

New disclosures about government assistance are effective for calendar year-end business entities in their

2022 annual financial statements. The disclosures, required by ASC 832, include (1) significant terms and conditions of government assistance transactions, (2) accounting policies applied and (3) the effect on impacted financial statement line items. Section 3.10.3 of our *Financial statement presentation* guide has more details.

Looking forward to proxy season, many SEC registrants will be required to include new disclosures related to executive compensation in their upcoming proxy statements. Among other things, amended rules require tabular presentation of compensation actually paid to executive officers, along with a number of performance measures. Companies should start preparing now, as they may need to gather additional information, such as year-end fair value measurements of stock-based compensation awards. Additional information can be found in our In brief, *SEC adopts pay versus performance disclosure rules*.

### Subsequent events

In the current environment, TMT companies need to be prepared for events occurring after the period end that could require adjustment to the financial statements or disclosure in accordance with the subsequent events guidance in ASC 855. This includes having controls and processes in place to identify, evaluate, and potentially make adjustments for subsequent events up through the date the financial statements are issued. Our 2020 podcast, *Subsequent events, what you need to know,* is a helpful refresher on the framework and areas commonly impacted by subsequent events.

## Accounting for workforce reductions and other restructuring activities

PwC's latest Pulse Survey shows that many companies continue to scale back in areas that don't support their strategic growth initiatives. For example, 29% of TMT leaders say they plan to reduce the number of full-time employees during the next year or 18 months. The financial reporting impact of workforce reductions and other cost-cutting measures can vary. In some cases, the impact may be recognized immediately in the financial statements; however, not all actions will receive immediate recognition.

### Employee termination benefits

Workforce reductions often include termination benefits such as severance payments to departing employees. The accounting for these benefits depends on their type:

- **One-time involuntary termination benefits:** Recognize when all of the conditions in ASC 420-10-25-4 are met (including management's commitment to a plan that is sufficiently detailed) and the benefit arrangement has been communicated to employees.
- **Termination benefits provided under an existing plan:** Recognize when it is probable employees will be entitled to the benefits and that the amount is reasonably estimable.
- **Benefits provided to employees electing voluntary termination (e.g., early retirement):** Recognize when employees irrevocably accept the offer and the amount of the termination liability is reasonably estimable.

The differences in the guidance outlined above could result in costs being recorded in more than one period if employees receive a combination of benefit types. For example, employees may receive termination

benefits under an existing plan (recognized when probable and estimable) along with an incremental one-time benefit (recognized and only once communicated to employees). Refer to Chapter 8 of PwC's *Pensions and employee benefits* guide for further information.

Companies also frequently accelerate the vesting of stock-based compensation awards that would have otherwise been forfeited in connection with involuntary employee terminations. If the acceleration is a modification of the award (that is, it was not provided for in the original terms of the award), it is a "Type III" (or "improbable-to-probable") modification under ASC 718, *Stock Compensation*. In that case, compensation cost is recognized as equal to the fair value of the award on the modification date and recognized over the remaining service period, if any. If the award's original terms provide for automatic acceleration of vesting upon involuntary termination, the acceleration is not treated as a modification since it is not a discretionary action; however, the requisite service period may have changed once involuntary termination becomes probable. The change in requisite service period should be recognized on a prospective basis. Refer to Section 4.3.2 of PwC's *Stock-based compensation* guide for further information.

### Ceasing the use of or abandoning leases

As part of managing costs, many companies continue to reassess their use of leased real estate, which can trigger impairment assessments of the right-of-use asset recognized under ASC 842, *Leases*. The right-of-use asset is subject to the impairment guidance in ASC 360, *Property, Plant and Equipment*; that is, it is tested for impairment at the asset group level. However, if a lessee decides to cease use of leased space — either immediately or at some point in the future — it will need to consider whether the associated right-of-use asset is, or will be, abandoned under ASC 360. Temporarily idling a right-of-use asset is not considered an abandonment. Similarly, vacating leased space with plans to sublease the space in the future does not constitute an abandonment because the lessee could potentially economically benefit from the right-of-use asset in the future. Refer to Section 6.3.1.1 of our *Property, plant and equipment* guide for further information.

### Other contract terminations or modifications

Costs to terminate a contract (that is not a lease) for the purchase of goods or services are recognized and measured at fair value when the company terminates the contract in accordance with ASC 420-10, *Exit or Disposal Cost Obligations*. However, if the company continues to receive a benefit from a contract, the related costs should be recognized as the goods or services are received. For example, if the company will continue to utilize some, but not all, of the services under a noncancellable service contract, in effect, the cost of the services being utilized has increased. It is generally not appropriate to accrue anticipated losses on an executory contract in advance of those losses being incurred unless required by specific US Generally Accepted Accounting Principles (GAAP) guidance. For example, ASC 330-10, *Inventory*, requires recording a loss related to firm commitments to purchase inventory in certain circumstances. This guidance should not be applied by analogy to other arrangements.

Companies may also renegotiate contracts with customers, such as long-term contracts, at unfavorable prices. The partial or complete termination of a revenue contract is typically accounted for by applying the modification guidance in ASC 606, *Revenue from Contracts with Customers*. The accounting for a modification that reduces the scope of a contract depends on whether the remaining goods or services in

the contract are distinct from the goods or services transferred before the modification:

- If the remaining goods or services in the contract are not distinct (e.g., a single performance obligation is being modified), the modification is accounted for on a cumulative catch-up basis.
- If the remaining goods or services in the contract are distinct, the modification is accounted for prospectively as if it were a termination of the existing contract and the creation of a new contract.

For modifications accounted for prospectively, payments made to or received from customers in connection with the renegotiation typically impact the amount of revenue recognized prospectively for the remaining goods or services. Refer to Section 2.9 of our *Revenue from contracts with customers* guide for further information.

### For more information

For further details on the accounting for disposal activities, exit costs and restructuring charges, refer to Section 6.4 of our *Property, plant and equipment* guide. For discussion of various issues that may arise in the current economic environment, read our In depth, *FAQ on accounting in uncertain economic times*.

## Update: Accounting for transferable credits provided by the IRA

The Inflation Reduction Act , signed into law in August, 2022, includes significant tax incentives for energy and climate initiatives. We continue to update our guidance as accounting interpretations evolve related to the provisions of the IRA, including the accounting for transferable credits that may be used by a reporting entity as a reduction of income tax payable on its income tax return or sold to another taxpayer. As it relates to the specific credit transferability provisions introduced by the IRA, we understand that the FASB staff believes it is most appropriate to account for such credits as part of the provision for income taxes under ASC 740, *Income Taxes*, regardless of whether the reporting entity that receives the credit claims the credit on its tax return or if that entity sells the credit to another taxpayer. Because there is no directly applicable GAAP, the FASB staff acknowledges that other views may be acceptable. Read PwC's updated In depth, *Accounting for the Inflation Reduction Act and the CHIPS Act*, for the latest insights.

## FASB issues proposals on segment reporting and common control leases

In October, the FASB issued an exposure draft proposing new segment disclosure requirements. The proposal would not impact how companies identify their reportable segments; however, it 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 proposal would require disclosure of the title and position of the CODM, and would 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. Comments on the proposal are due December 20, 2023.
The FASB also issued an exposure draft of a proposal in November 2023 that would permit all companies to amortize leasehold improvements related to common control leases over their economic life regardless of

lease term. It would also allow private and certain not-for-profit entities to use the written terms and conditions of a common control arrangement without further assessing legal enforceability of those terms. Comments on the proposal are due January 16, 2023.

## FASB votes to issue exposure draft on income tax disclosures

In November, the FASB voted to move forward with a proposal focused on the disclosure of (a) income taxes paid and (b) the rate reconciliation table.

The FASB voted to propose that the disclosure of income taxes paid be disaggregated by federal, state and foreign taxes — on both an interim and annual basis. On an annual basis, companies would disclose income taxes paid disaggregated by individual jurisdiction using a quantitative threshold of 5% of total income taxes paid.

Public business entities would also be required to provide, on an annual basis, rate reconciliation information by specific categories, including state and local income tax; the effect of cross-border tax laws; foreign tax effects;, and tax credits, among others. Companies would separately disclose reconciling items by nature using a quantitative threshold of 5%, as well as by jurisdiction in the foreign tax effect category.

There would also be additional qualitative disclosures required.

The FASB decided the proposed amendments will be applied on a retrospective basis. The exposure draft is expected in the upcoming months and will have a comment period of 75 days. For more information, refer to the FASB's project page.

# Regulatory update

On the regulatory front, we take a closer look at the SEC's recently finalized rules for clawbacks of erroneously awarded executive compensation and provide an update on ESG reporting proposals. We also look at the most recent trends in SEC comment letters for TMT companies.

## Year-end messages from the regulators and standard setters

The 2022 Association of International Certified Professional Accountants (AICPA) & Chartered Institute of Management Accountants (CIMA) Conference on Current SEC and Public Company Accounting Oversight Board (PCAOB) developments is just wrapping up as of this publication date. The highly anticipated annual conference features representatives from the SEC, PCAOB, FASB and International Accounting Standards Board (IASB), along with many other distinguished speakers discussing both the latest financial reporting developments and what to expect in the coming year. For the key messages and takeaways, tune into our Q4 2022 Quarterly Accounting Webcast and stay tuned for further resources that are coming soon.

## Final rules for clawbacks of erroneously awarded executive compensation

In October, the SEC adopted final rules regarding the recovery of erroneously awarded, incentive-based executive compensation. The rules direct US securities exchanges to establish standards to require listed issuers to develop and implement a written policy providing for the recovery of incentive-based compensation received by current and former executive officers in the event of a required accounting restatement when that compensation was based on an erroneously reported financial reporting measure. New Exchange Act Rule 10D-1 sets forth the detailed requirements that must be included in the issuer's clawback policy, including a broad definition of people who would be considered executive officers (which is more inclusive than definitions of the same term used in other SEC rules) and guidance relating to the types of accounting restatements that would trigger the recovery requirements. As detailed in the new rule, this would include any required accounting restatement within a three-year look-back period (immediately preceding the date the issuer is required to prepare the restatement). As defined, an accounting restatement is one that:

- corrects an error in previously issued financial statements that is material to the previously issued financial statements (i.e., a "Big R" restatement) or
- would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period (i.e., a "little r" restatement).

The new rule and related amendments include a number of new disclosure requirements, including requiring issuers to file their recovery policy as an exhibit to their annual reports and establishing new cover page disclosures on Forms 10-K, 20-F and 40-F indicating whether the financial statements included in the filing reflect the correction of an error and whether the error correction required an incentive-based compensation recovery analysis.

### Effective date

The exchanges must file proposed listing standards to implement the SEC's directive no later than February 26, 2023 (which is 90 days after the final rules were published in the Federal Register), and those listing standards must be effective no later than November 28, 2023. Affected issuers will be required to adopt a recovery policy no later than 60 days after the listing standards become effective.

### For more information

Read PwC's In depth, *SEC adopts executive incentive compensation clawback rules*, for questions and answers that detail some of the key provisions of the new rule and related amendments.

## ESG reporting: Next steps for global proposals

Over the past quarter, standard setters and regulators worldwide have been busy discussing next steps on proposed sustainability reporting requirements. While the SEC continues to review the letters received in response to its proposed rule on climate disclosures, both the European Financial Reporting Advisory Group (EFRAG) and the International Sustainability Standards Board (ISSB) publicly progressed the development of their reporting standards in response to comments received on their respective exposure drafts issued for public consultation earlier this year.

### Corporate Sustainability Reporting Directive (CSRD) / EFRAG reporting standards

In November, both the European Parliament and the Council of the European Union adopted the CSRD, which includes mandatory sustainability disclosures for in-scope companies. EU member states will have 18 months to incorporate the CSRD into their own national laws once it is published in the Official Journal of the European Union. The scope of the CSRD is broad and includes US and other non-EU companies with EU subsidiaries. In addition to subsidiary or EU-level reporting, some non-EU parent companies will be required to report at the global consolidated level. Disclosure and assurance requirements would be applicable as soon as fiscal year 2024 for the first companies in scope of reporting. In addition, the EFRAG Sustainability Reporting Board submitted the first set of draft European Sustainability Reporting Standards (ESRS) to the European Commission in November. The ESRS detail the reporting requirements of the CSRD and cover a broad range of environmental, social and governance matters. Adoption of the standards is expected in mid-2023. For more background, including details on the scope of the CSRD, read PwC's In the loop, *What's CSRD? It's important to know* and In brief, *EFRAG submits draft European Sustainability Reporting Standards to the European Commission*.

### ISSB's IFRS Sustainability Disclosure Standards

During redeliberations, the ISSB confirmed many of its original proposals from the two exposure drafts — including the requirement to disclose Scope 3 greenhouse gas emissions — and tentatively decided to change other key provisions, including removing the concept of "enterprise value" from the objective and description of materiality. They are also proposing to remove the requirement to use the Sustainability Accounting Standards Board standards to report industry-specific disclosures on climate. The ISSB expects to finalize the two standards in early 2023. During COP27 in November, the first jurisdiction, Nigeria, announced its intention to

adopt the ISSB standards when issued. For more background, read PwC's In depth, *What you need to know about the ISSB Exposure Drafts*.

### For more information

Looking for more information on steps to take now on ESG reporting? Read PwC's In the loop, *ESG reporting: Preparing for tomorrow's rules today*, or listen to the on-demand audio version.

## What you need to know about the OECD minimum tax

The current international tax landscape has been in place for decades, but dramatic changes may be on the horizon. The Organisation for Economic Cooperation and Development (OECD), backed by countries around the world, has been pursuing a "Two-Pillar Solution" aimed at alleviating certain global tax challenges that it believes arose from the "digitalization of the economy." This OECD two-pillar framework will significantly alter many international tax practices followed today with a related impact on reported earnings. In preparation, all companies should begin to assess what the OECD's proposed framework will mean to them. Read PwC's In the loop, *The OECD minimum tax: What US companies need to know*, or listen to the on-demand audio version for more background on the framework and how it will impact US companies.

## 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. Read more on SEC comment letter trends for TMT companies, which provides insights on the nature of the SEC staff comments, sample text from the comments, and provides links to sites where you can learn more about the accounting and disclosure requirements addressed in each area. PwC also kicked off its *What's trending in SEC comments* podcast series in November. In each episode, guests discuss the latest themes in comment letters from the SEC's Division of Corporation Finance for the most common topical areas of the financial statements.
Within the TMT sector, the top three areas of focus for the 12 months ending September 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.  Our global network of more than 327,000 professionals in 155 countries is committed to advancing quality in everything we do.

**Let's talk**

For deeper insights into 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. We're here to help.

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