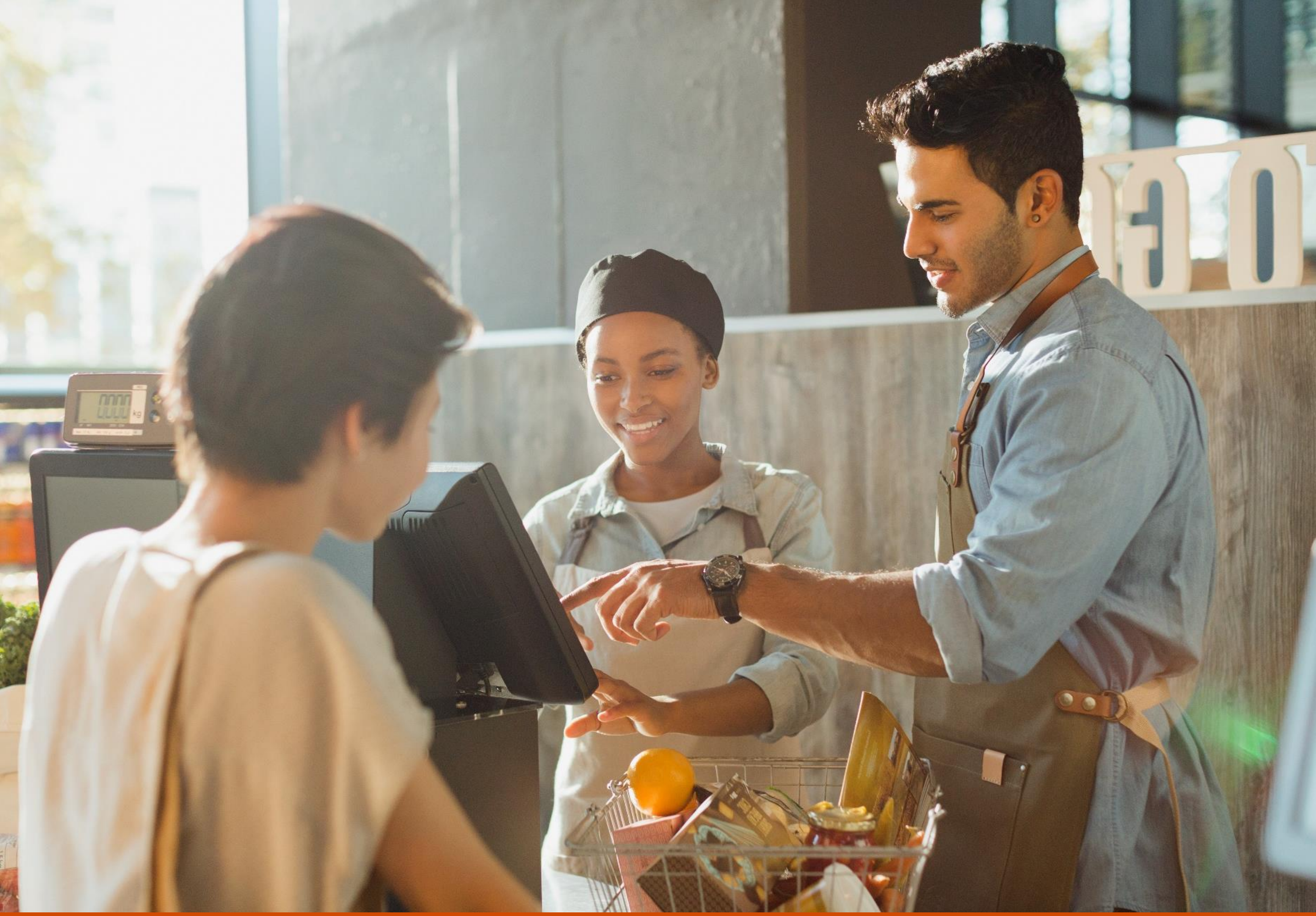

Consumer Markets insights

A quarterly summary for the Consumer Markets sector

December 2023

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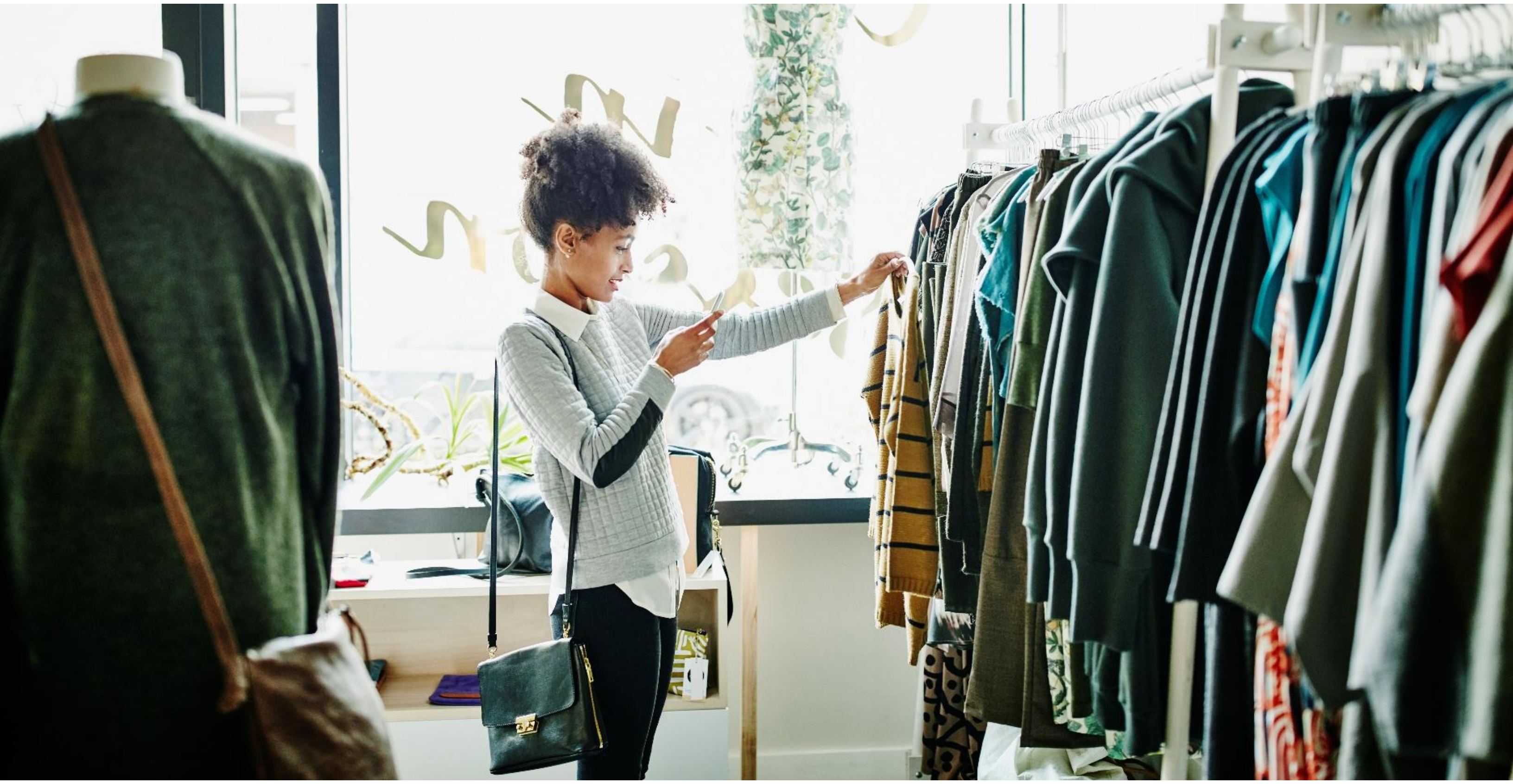

Introduction

We are pleased to share our quarterly Consumer Markets (CM) insights publication. This report provides some of the latest industry, accounting, and regulatory updates of interest to the Consumer Markets sector. Please reach out to the authors listed on the last page of this document with any feedback or ideas for future publications.

Strategy for business

Holiday Outlook 2023

Shoppers want everything everywhere … all at discounts.

Consumers are on the hunt for deals this holiday season. Most will browse first in stores. To fine tune their choices, they will turn to a variety of online options — search engines, online marketplaces, brand sites and social media. Then, there will be a combo of store and online to finalize and buy.

Some — especially young male high-earning consumers in metro areas — are particularly interested in using a variety of emerging technologies such as generative AI (GenAI) and chatbots to help sleuth out the right gift.

Cued by consumers' propensity for online search, retailers are prioritizing emerging tech by embedding AI and GenAI into their business models — acutely aware that shoppers demand a seamless combination of digital and physical options to choose, compare and buy gifts.

To find out what matters to them, we asked some 4,000 consumers to estimate how much they plan to spend this holiday season, as well as when and where they will shop and travel. Here's what they told us.

Customer Loyalty: Driving growth

Brand matters. That's what almost two-thirds of consumers (63%) told us when we asked what influences holiday shopping decisions. Ultimately, shoppers define a brand by the overall experience it provides.

The experience is made of a variety of factors – from speed, convenience and price to quality, reliability and consistency.

Read more about who and what defines loyalty as well as how to succeed in using customer loyalty as your growth engine.

PwC Pulse Survey: Focused on reinvention

US companies are shifting from defense to offense. In our latest Pulse Survey, business executives say they're less focused on reacting to external disruptions and instead looking inward, to transform and reinvent. After three years of complex challenges — including the pandemic, supply chain disruptions, a shift to hybrid work, rising interest rates and increased economic uncertainty — the business environment is finally starting to stabilize. Recessionary fears are easing, consumer spending has held up and confidence is rising.

Executives now have the opportunity to transform their companies — and capitalize on economic expansion when it starts to ratchet up again. The biggest transformation priorities? Embedding technology and investing in the workforce.

Our survey provides insights into what's top of mind for executives as they look to transform their businesses and how they are navigating through the changes, including managing risk related to new technologies, building their climate policies and engaging and retaining their people.

US Deals 2024 outlook

M&A activity has been hampered as dealmakers seek clear economic signals. The swings of COVID-era volatility have subsided, but executives are still searching for equilibrium in a world with sizable valuation gaps, higher-for-longer interest rates and geopolitical-driven economic de-couplings.

While deals are still getting done, many executives have taken a wait-and-see approach, especially when it comes to the transformational deals that abounded in prior years. But hesitancy isn't stopping the clock from ticking. Business reinvention is an imperative across industries; business-as-usual strategies need the catalyst of transformation to achieve the growth and profit expectations in current valuations. A combination of divestitures and acquisitions are increasingly the fuel to accelerated business transformation.

Savvy leaders that "transact to transform" now have a chance to create greater value and gain an edge on less decisive competitors. To execute successful M&A in 2024, dealmakers will be required to develop value creation plans at the onset, use effective screening and diligence capabilities to identify the right targets, and then act decisively to seize opportunities. By doing so, companies can use a period of broad uncertainty to create separation between themselves and their competitors while also developing a platform for success if M&A and capital markets rebound to levels seen in 2021 and 2022.

Read more about the US Deals 2024 outlook here as well as specific consumer markets sector insights.

Navigating the ESG landscape

After years of increasingly vocal demand for enhanced transparency about ESG matters from investors and other stakeholders, regulators and standard setters in various jurisdictions issued definitive proposals to transform ESG reporting in 2022. The year brought proposed ESG disclosures from the European Union (EU) as part of the Corporate Sustainability Reporting Directive (CSRD), internationally by the International Sustainability Standards Board (ISSB), and in the United States (US) by the SEC. These “big three” disclosure frameworks each detail expansive sustainability requirements.

The sustainability disclosures required by the ISSB and in the EU were finalized in June and July 2023, respectively. And while the final SEC rule is still pending, three bills signed into law by the California Governor in October 2023 are poised to change the landscape of climate reporting in the US. The California laws require (1) greenhouse gas (GHG) emissions reporting in compliance with the Greenhouse Gas Protocol (GHG Protocol), (2) climate-related financial risk reporting in line with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), and (3) disclosure of information about certain emissions claims and the sale and use of carbon offsets. Both the GHG Protocol and TCFD requirements should be familiar to companies given their reference in the SEC’s climate disclosure proposal, the European Sustainability Reporting Standards (ESRS), and IFRS® Sustainability Disclosure Standards. The number of entities in scope of the California laws, however, goes well beyond that of the SEC’s climate disclosure proposal because the requirements apply to both public and private companies with business activities in California.

The laws are brief — only a few pages each — and lack answers to some questions regarding how and when to apply the requirements. The California Air Resources Board (CARB) is expected to provide more detailed guidance on SB 253 and SB 261 in regulations required to be issued prior to January 1, 2025. But there are no definitive plans to develop additional guidance for AB 1305 and the initial disclosure requirements are imminent. We recommend that companies evaluate applicability and reporting requirements related to all of the laws based on what is known now, to prepare for what may be a company’s first foray into mandatory climate-related disclosure.

For more information, refer to our publication, California's not waiting for the SEC's climate disclosure rules.

Given the geographic reach of these frameworks and their potential to encompass a broad spectrum of value chain contributors, most companies are expected to be impacted in some way. Proactive companies are in the process of assessing the applicability so that they are prepared to meet potentially short reporting deadlines.

An SEC registrant that has a subsidiary listed in the EU, and a subsidiary in a jurisdiction that requires ISSB™ reporting, for example, may be subject to all three requirements, plus the new California bills.

With equivalency — that is, whether disclosures for one reporting framework can satisfy some or all of the requirements of another — not yet determined, companies captured in multiple reporting regimes have a vested interest in understanding which reporting applies.

Further, understanding where the frameworks align and diverge will help companies develop the requisite reporting strategy, data gathering processes, and related controls, providing for a streamlined process and effective deployment of resources.

Our summary publication compares and contrasts key provisions among the ESRS, the standards issued by the ISSB, and the SEC proposal, and includes select commentary on the California climate disclosure laws. By understanding the different requirements, preparers can develop the appropriate reporting strategy, one designed to capture the right data the first time

Accounting and financial reporting hot topics

Spotlight on the statement of cash flows

The statement of cash flows is an important component of the financial statements that should not be left to the last minute in the year-end reporting process. On December 4, Paul Munter, SEC Chief Accountant, released a public statement emphasizing the importance of the statement of cash flows to investors and observing that it has consistently been a leading area of restatements and material weaknesses in internal control over financial reporting. Given that the guidance for the statement of cash flows is largely principles-based, questions often arise regarding how the guidance should be applied to specific transactions. Below we address a few common questions that have become even more relevant in the current economic environment.

When can cash flows be presented on a net basis?

As a general principle, gross cash flow presentation on the statement of cash flows is required for most transactions. However, netting cash flows is permitted for items that have quick turnover, occur in large volumes, and have short maturities (i.e., less than 90 days). Some companies have expanded the use of revolving lines of credit, raising questions about when the net presentation of cash proceeds and repayments under a revolving line of credit would be appropriate. Net presentation is permitted only for individual borrowings under the credit arrangement that have contractual maturity dates within 90 days of the borrowing date, regardless of the timing of the actual repayment.

What qualifies as restricted cash and how is it presented in the statement of cash flows?

Restricted cash and restricted cash equivalents are not defined terms in the guidance. While not defined, we believe restricted cash and cash equivalents should generally include amounts that are legally restricted as to withdrawal or usage. If a company can access the cash or cash equivalents without any legal or contractual consequence, the cash is likely not legally restricted. There may be reasons why a company views cash and cash equivalents as restricted beyond those that are legally restricted; this is subject to the company's accounting policy, which should be applied consistently.

The statement of cash flows reflects all changes in cash, cash equivalents, restricted cash, and restricted cash equivalents. While restricted cash or cash equivalents are not required to be presented separately on the balance sheet, the guidance requires separate disclosure of these amounts. When restricted cash and restricted cash equivalents are included in multiple line items on the balance sheet, reporting entities are required to reconcile the total amount of cash, cash equivalents and restricted cash presented on the statement of cash flows to the amounts on the balance sheet.

How do foreign currency transactions and foreign operations impact the statement of cash flows?

The elevated volatility in foreign currency exchange rates may have a greater impact on the statement of cash flows than in the past. Accounting conventions related to foreign currency that did not previously have a material impact may no longer be appropriate in the current more volatile environment. It is important to note that changes in foreign currency exchange rates do not themselves result in cash flows. As a result, adjustments need to be made to the statement of cash flows to reflect the impact appropriately:

Foreign currency transaction gains or losses resulting from the remeasurement of monetary assets and liabilities denominated in foreign currencies should be reflected in the reconciliation of net income to operating cash flows under the indirect method.

The effect of exchange rate changes on cash and cash equivalents that are denominated in currencies other than the reporting currency needs to be calculated and presented as the "fourth category" on the statement of cash flows. This is computed by adding (1) net cash flow activity measured in the functional currency multiplied by the difference between exchange rates used in translating functional currency cash flows and the exchange rate at year end and (2) the fluctuation in the exchange rates from the beginning of the year to the end of the year multiplied by the beginning cash balance denominated in currencies other than the reporting currency.

For more information

For more guidance on the statement of cash flows, refer to Chapter 6 of our Financial statement presentation guide. You may also want to revisit our podcast, 2022 Year-end toolkit: Conquering the cash flow statement, as you prepare for 2023 year-end reporting.

Standard setting updates

New and returning Board members appointed to the FASB

This quarter, the Financial Accounting Foundation announced its appointment of Hillary Salo to the FASB and reappointment of Susan Cosper to the FASB for a second term. Ms. Salo currently serves as technical director of the FASB and will succeed James Kroeker, who is completing his second term as a Board member. Ms. Salo's five-year term will begin on July 1, 2024 after which she will be eligible for a second term. Ms. Cosper will begin her second five-year term effective July 1, 2024.

FASB issues final standard on segment reporting

In November, the FASB issued ASU 2023-07, which requires incremental disclosures about a public entity's reportable segments but does not change the definition of a segment or the guidance for determining reportable segments. The new guidance requires disclosure of significant segment expenses that are (1) regularly provided to (or easily computed from information regularly provided to) the chief operating decision maker and (2) included in the reported measure of segment profit or loss. The new standard also allows companies to disclose multiple measures of segment profit or loss if those measures are used to assess performance and allocate resources. The guidance is effective for calendar year-end public entities in 2024 and should be adopted retrospectively unless impracticable. Early adoption is permitted. For more information, refer to our publication, FASB updates segments guidance.

Coming soon: final standards on income tax disclosures and crypto assets

Before 2023 comes to a close, the FASB is expected to issue two additional new standards: (1) income tax disclosures and (2) accounting for and disclosure of crypto assets. Look for our publications with more information when the new standards are issued.

Income tax disclosures

On December 14, the FASB issued ASU 2023-09, which requires significant additional disclosures about income taxes, primarily focused on the disclosure of income taxes paid and the rate reconciliation table. The new guidance will be applied prospectively (with retrospective application permitted) and will be effective for calendar year-end public business entities in the 2025 annual period and in 2026 for interim periods, with early adoption permitted. All other entities will have an additional year to adopt the new guidance. For more information, refer to the our publication FASB issues guidance on income tax disclosures.

Accounting for and disclosure of crypto assets

On December 13, the FASB issued ASU 2023-08, which provides accounting and disclosure guidance for crypto assets that meet the definition of an intangible asset and certain other criteria. In-scope assets are subsequently measured at fair value with changes recorded in the income statement. The standard will require separate presentation of (1) in-scope crypto assets from other intangible assets and (2) changes in the fair value of those crypto assets. Disclosure of significant crypto asset holdings and an annual reconciliation of the beginning and ending balances of crypto assets will also be required. Companies will apply the new guidance by making a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the annual period the guidance is adopted. The guidance will be effective for all calendar year-end companies in 2025, including interim periods, with early adoption permitted. For more information, refer to our publication, FASB issues guidance on accounting for crypto assets.

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

FASB adds new projects to its technical agenda

After wrapping up multiple projects on its technical agenda, the FASB voted this quarter to add three new projects related to government grants, the statement of cash flows, and the scope of the derivatives guidance.

Accounting for government grants

As a follow-up to its 2022 invitation to comment, the FASB decided to add a project to address the accounting for government grants received by business entities. Currently, there is no specific US GAAP guidance on this topic; as a result, companies generally look to other guidance by analogy, including international standards (IAS 20). The scope of the new project will include transfers of monetary and tangible nonmonetary assets from a government to a business entity, including forgivable loans. The FASB also made preliminary decisions regarding the accounting model, including specifying that a government grant should be recognized when it is probable that (1) the entity will comply with the conditions of the grant and (2) the grant will be received. For more information, refer to the FASB's project page.

Statement of cash flows

The FASB added a project to make targeted improvements to the statement of cash flows. The scope of the new project is to (1) reorganize and disaggregate the statement of cash flows for financial institutions to improve the decision-usefulness of that statement and (2) develop a disclosure about cash interest income received. For more information, refer to the FASB's project page. The FASB chair decided to retain a research project on the statement of cash flows to explore further potential improvements.

Derivatives scope refinements

The FASB added a project to refine the scope of the derivatives guidance, deciding to amend ASC 815, *Derivatives and Hedging*, to incorporate a scope exception for contract with underlyings based on the operations or activities that are specific to one of the parties to the contract. The FASB also directed the staff to perform further research on (1) refining the "predominant characteristics" test in ASC 815 and (2) the interaction between ASC 815 and ASC 606, *Revenue from contracts with customers*, related to certain revenue arrangements involving noncash consideration. For more information, refer to the FASB's technical agenda.

Project spotlight

Accounting model for environmental credits takes shape

In October, the FASB made several tentative decisions related to its project on the accounting for environmental credit programs. The FASB decided the scope of the project will include environmental credits that are an enforceable right that is acquired, internally generated, or granted by a regulatory agency and meets certain criteria, including being separately transferable in an exchange transaction. Income tax credits, regardless of how the company intends to utilize the credit, are excluded from the project's scope.

The FASB tentatively decided that in-scope credits would be recognized as an asset when it is probable that the credit will be (1) used to settle an environmental credit obligation or (2) separately transferred in an exchange transaction. Accordingly, credits acquired to achieve a voluntary goal or target would not qualify for asset recognition and would be expensed as incurred. Environmental credits would be initially measured at cost. Credits that are probable of being used to settle environmental credit obligations would not be subsequently remeasured, while other credits would be subsequently measured at historical cost less impairment losses, if any.

At future meetings, the FASB will discuss the accounting model for environmental credit obligations, among other remaining reporting and disclosure matters. For more information, refer to the FASB's project page.

Tax accounting method change for inventory shrinkage may benefit retailers experiencing thefts

Retailers may be able to use inventory shrinkage reserves determined under US GAAP to account for damage and theft for tax purposes. Considering the recent spike in thefts, a retailer that currently uses the retail safe harbor method to account for inventory shrinkage may benefit from a change in accounting method.

Inventory shrinkage is a discrepancy between the inventory in a taxpayer's records and actual physical inventory on hand, often arising from theft, damage, or bookkeeping errors. A taxpayer determines actual shrinkage by taking a periodic physical count of goods on hand, which typically is done several months before the end of the year. Under GAAP, a taxpayer may maintain a reserve that estimates the inventory shrinkage that occurs between the date of the last physical count and the end of the year – i.e., the "stub period." Section 472(b) permits a taxpayer to estimate inventory shrinkage if the taxpayer normally takes a physical count of inventories at each location on a regular and consistent basis and makes proper adjustments to account for the difference between estimated shrinkage and actual shrinkage.

Retailers typically compute an inventory shrinkage reserve under GAAP that is based on actual inventory shrinkage for the current year. For tax purposes, many retailers use the retail safe harbor method authorized in Rev. Proc. 98-29 to estimate inventory shrinkage for the stub period. The retail safe harbor method is based on average actual inventory shrinkage for the current tax year and the two preceding tax years. Rev. Proc. 98-29 provides that retailers generally may use any other method of accounting to estimate inventory shrinkage if the method is reasonable and clearly reflects income.

Because of a recent spike in thefts experienced by many retailers, the inventory shrinkage reserve used under GAAP may exceed the estimated inventory shrinkage computed under the retail safe harbor method. Therefore, retailers may have an opportunity to increase cost of goods sold and reduce taxable income by changing from the retail safe harbor method to the GAAP method of estimating inventory shrinkage.

Observation: In our experience, the IRS generally has accepted a taxpayer's GAAP inventory shrinkage method as a reasonable tax method that clearly reflects income.

For retailers using the retail safe harbor method, changing to the GAAP method for estimating inventory shrinkage is a nonautomatic method change that would have to be filed by the end of the taxpayer's tax year, which, for many retailers, is January 31, 2024. However, a retailer that does not claim estimated inventory shrinkage for tax purposes generally would qualify to change its tax method of accounting to the GAAP inventory shrinkage method under the automatic method change procedures.

Observation: Inventory shrinkage may be considered under either a first-in, first-out (FIFO) or last-in, first-out (LIFO) method because estimated shrinkage measures a loss of quantity, not a loss in value -- which would be impermissible under LIFO.

Regulatory update

Year-end disclosure reminders

There are a number of new SEC rules that will be effective beginning at the end of 2023. We have summarized several of the new rules below, including where you can find more information.

Cybersecurity risk governance

Issuers will be required to comply with annual disclosure requirements beginning with annual reports for fiscal years ending on or after December 15, 2023. Annual disclosure requirements include material information regarding a registrant's cybersecurity risk management, strategy, and governance. Form 8-K disclosure requirements related to material cybersecurity incidents were required beginning December 18, 2023. For more information, refer to our In brief, SEC adopts cybersecurity disclosure rules.

Clawbacks of Executive Compensation

Issuers will be required to comply with the new rules on Form 10-K beginning with the filing that covers any period that begins on or after December 1, 2023. Listed issuers are required to file their recovery policy as an exhibit to their annual reports. Annual reports should also include new cover page disclosures and new disclosures of any actions the company has taken pursuant to such recovery policies. For more information, refer to our In depth, SEC adopts executive incentive compensation clawback rules.

Rule 10b5-1 and Insider Trading

Issuers will be required to comply with the new disclosure requirements in Exchange Act periodic reports on Forms 10-Q and 10-K and in any proxy or information statements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023. Smaller reporting companies have an additional six months to comply with the amended rule. For a calendar year-end company that is not a smaller reporting company, quarterly disclosures were required beginning with the June 30, 2023 Form 10-Q. Annual disclosures will be required beginning with the December 31, 2024 Form 10-K. Annual disclosure requirements include disclosure of the use of Rule 10b5-1 plans and certain other written trading arrangements by a registrant's directors and officers for the trading of its securities. More information can be found within the final rule.

Share repurchase disclosures

On October 31, an appeals court found that the SEC "failed to respond to petitioners' comments and failed to conduct a proper cost-benefit analysis" in the final rule under the Administrative Procedure Act. In its opinion, the court stopped short of vacating the rule but instead directed the SEC to remedy deficiencies in the rule within 30 days. On November 22, the SEC issued an order that postpones the effective date of the rule pending further Commission action. On November 26, the court denied an SEC request to extend the 30-day deadline from the court's October 31 ruling. That 30-day window closed at midnight on November 30.

The effective date of the share repurchase rule is postponed pending further SEC action. The SEC was required to respond to the court by midnight on November 30. It is unclear at this time how or when the court may take any further action. In the interim, entities are required to report share repurchase activity consistent with existing requirements.

For more information, refer to our In brief, SEC postpones effective date of share repurchase disclosure rule.

SEC comment letter trends

The SEC's Division of Corporation Finance's filing review process is a key function utilized by the SEC staff to monitor the 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 change over time. Within the Consumer Markets sector, the top five areas of focus in comment letters are:

1. Non-GAAP measures - compliance with Item 10(e) of Regulation S-K and the related compliance and disclosure interpretations
2. MD&A - emphasis on the requirements in Item 303 of Regulation S-K and the related disclosure objectives
3. Climate change matters - while the SEC has proposed sweeping new climate-related disclosures, in 2021 the SEC staff began a renewed focus on the quality and adequacy of climate-related disclosures under existing rules, specifically as detailed in the SEC's 2010 interpretive release. The staff continues issuing comments related to climate change disclosures on both annual reports on Form 10-K and registration statements. These comments are largely focused on information related to climate change-related risks and opportunities that may be required in disclosures of a company's description of business, legal proceedings, risk factors, and MD&A. The staff also has been looking at other climate change-related disclosures that may be outside of SEC filings (e.g., Corporate Social Responsibility reports, investor presentations, information on websites) in formulating comments. Refer to our In the loop, Don't wait until the SEC staff asks you about climate change, for a summary of current SEC climate disclosure requirements and the related comment letters issued by the SEC's Division of Corporation Finance, along with the related responses from registrants.
4. Segment reporting - emphasis on the disclosure requirements of ASC 280
5. Inventory and cost of sales - focus on disclosing the basis of accounting for inventory and components of cost of sales, ensuring non-cash items, like depreciation, are allocated to cost of sales, and questioning the calculation of gross margin when such items are not allocated to cost of sales

Refer to the full list of comment letter trends specific to the Consumer Markets sector for the 12 months ended September 30, 2023. Additionally, PwC's Accounting podcast series focuses on the following common topical areas in comment letters:

What's trending in 2023 SEC comment letters

2023 SEC comment letter trends: non-GAAP measures

2023 SEC comment letter trends: Revenue

2023 SEC comment letter trends: Business combinations

2023 SEC comment letter trends: MD&A

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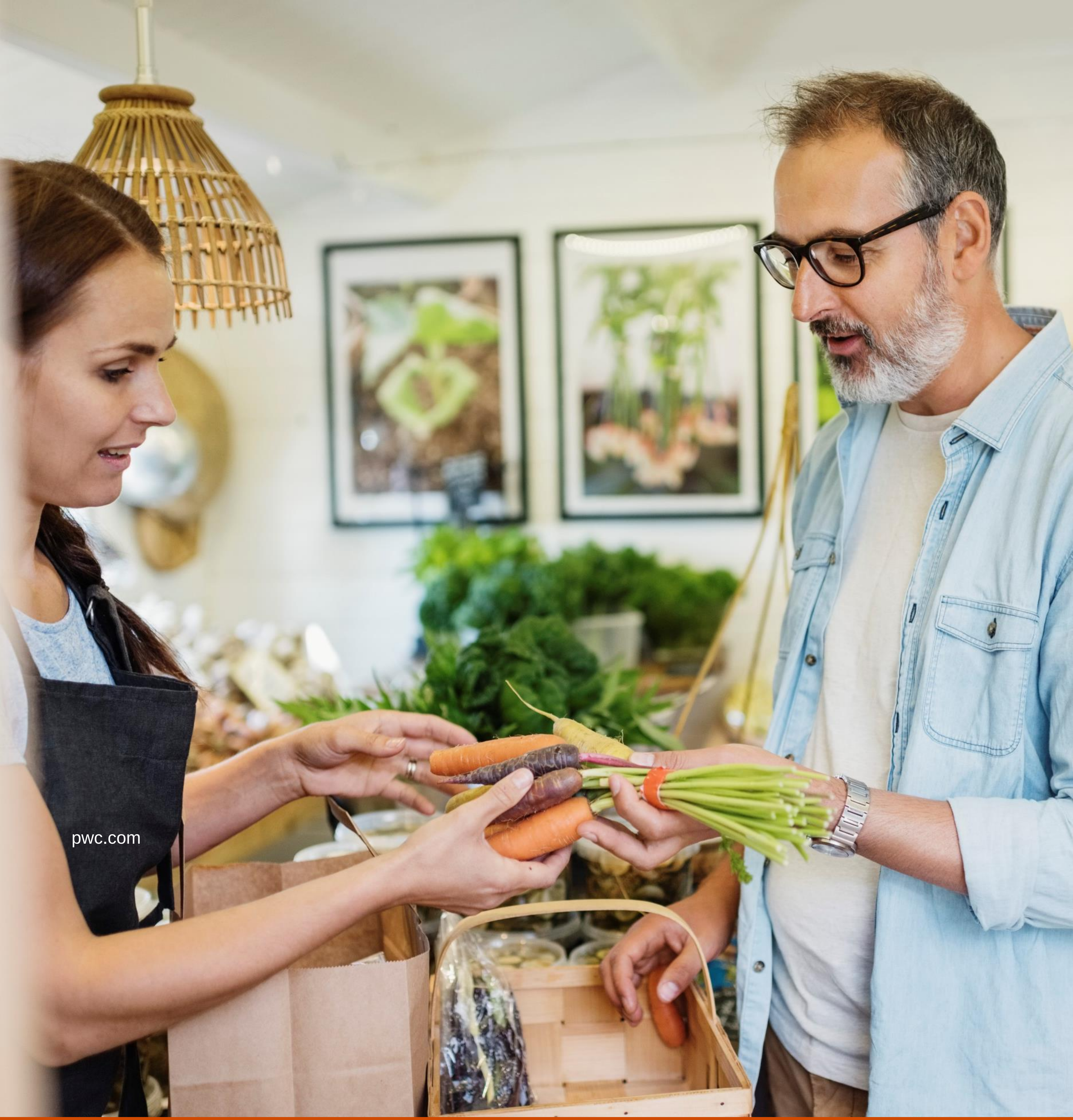

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