TMT insights: Financial reporting and accounting quarterly — Q4 2023

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

In this edition:

- Despite challenges from economic uncertainties, market volatility and geopolitical instability, stabilized inflation and interest rates in the second half of 2023 offer reasons for cautious optimism in capital markets.
- Receding inflation suggests an improved market tone for technology, media and telecommunications (TMT) deals in the near term.
- The FASB issued final standards on segment reporting, income tax disclosures and crypto assets.
- Accounting for income taxes is a year-end priority as TMT companies actively assess the realizability of deferred tax assets and evaluate the impact of legislative developments, including Pillar Two global minimum taxes.
- New California climate disclosure laws require expanded emissions reporting and the European Sustainability Reporting Standards for Corporate Sustainability Reporting Directive (CSRD) are finalized.
- SEC comment letter trends for TMT companies highlight focus areas such as non-GAAP measures, management's discussion and analysis, and revenue recognition.

Issue spotlight

Learn about key challenges and opportunities facing TMT companies as they head into 2024.

Business update

In 2023, capital markets faced challenges due to economic uncertainties, market volatility, and geopolitical instability. However, the stabilization of inflation and interest rates in the latter half of the year provides reasons for cautious optimism moving forward.

The receding inflation, primarily attributed to the Federal Reserve's monetary tightening, suggests an improved market tone for deals in the near term. Limited interest rate increases are expected, and the Fed may need to transition from mitigating inflation to promoting slower-paced growth. The ability to maintain this delicate balance will significantly influence the outlook for 2024.

TMT Deals

In the first half of 2023, the pace of technology mergers and acquisitions (M&A) activity continued to slow down, reflecting the levels seen in the previous quarter of 2022. In light of the Federal Reserve's interest rate hikes, certain companies adopted a more cautious approach to their M&A strategies. Instead of exploring new markets, they focused on enhancing profitability and consolidating their existing market positions.

However, the second half of 2023 witnessed a resurgence in M&A activity, as the volume of deals rebounded to the levels seen in 2021 and 2022. Despite this increase in volume, the overall value of deals remained below historical averages. In 2023, the average technology deal size dropped by 27% compared to 2022, reflecting a preference for less transformative and more financially prudent transactions.

As we look ahead to the first half of 2024, we anticipate the M&A market will continue to experience a subdued environment. Nevertheless, the combination of persistently low valuations and ongoing financial difficulties faced by start-ups could potentially lead to a rise in deal volume, albeit at reduced prices. According to our TMT publication, Technology: US Deals 2024 outlook: "Currently, we're in the investment phase of AI, with expectations for continued investment by large tech firms to ramp up AI investments and strategic AI-driven acquisitions targeting specific business applications. The competition among leading AI companies may trigger a wave of talent acquisitions ("acquihires"). Additionally, the computationally intensive nature of AI, coupled with its expanding applications, is likely to spur acquisitions related to cloud computing infrastructure and supply chain solutions as AI technologies become more widespread." For additional TMT deals insights, also read Media and telecommunications: US Deals 2024 outlook.

IPOs

Throughout 2023, numerous companies opted to delay their public offerings due to a combination of challenging market conditions, macroeconomic influences and a prevailing sense of caution among investors. The IPO market remained relatively inactive in 2023, making the last two years among the lowest volume years ever in the United States. Several high-profile IPOs were brought to market in the back half of the year but, despite successful pricings, most have subsequently traded under their listing prices. This sent a wave of caution through other potential IPO candidates that had been considering entering the market.

The lackluster reception of IPOs in 2023 has prompted numerous companies to postpone their exits, in the hopes of capitalizing on a more favorable market environment in early 2024. However, it is important to note that the window for such exits may be limited, as the uncertainty surrounding the late 2024 election cycle typically dampens investor enthusiasm. This is primarily due to the potential for regulatory and economic policy changes that could impact market dynamics.

Considering the lackluster performance of IPOs in 2023 and the approaching election cycle, there is an increasing accumulation of companies awaiting their IPOs. This backlog has the potential to result in a surge of IPO activity in 2025. Additionally, the backlog may also contribute to heightened M&A activity in 2024, as investors in these private companies explore alternative exit strategies due to the uncertainties and delays surrounding IPOs.

Read more insights in our publication, 2024 Capital Markets Annual Outlook.To hear more about what's next for the market in 2024, register for our webcast Path to Public: Capital Markets Annual Outlook.

Accounting update

In this issue, we highlight year-end reminders on perennial favorites, including SEC reporting, the statement of cash flows and income taxes. On the standard-setting front, we summarize the Financial Accounting Standards Board (FASB) significant activity during the quarter, including the issuance of final standards on segment reporting, income tax disclosures and crypto assets.

Year-end messages from the regulators and standard setters

The 2023 AICPA & CIMA Conference on Current SEC and PCAOB developments took place the first week of December. This 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, read our publication: In depth, 2023 AICPA & CIMA Conference: Current SEC and PCAOB Developments.

SEC reporting year-end reminders

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

Impact of the current environment

Similar to the past few years, TMT companies continue to operate in an environment with both economic and geopolitical uncertainty. SEC registrants need to be diligent in updating their disclosures to address current risks and uncertainties and their impact on the company's business and financial statements. Disclosures in the notes to the financial statements, MD&A (including critical accounting estimates and liquidity and capital resources), risk factors, and quantitative and qualitative market risk, should be revisited and updated, as needed. For example, MD&A should include discussion of material events and uncertainties known to management that are reasonably likely to cause reported financial information to not be indicative of future results.

The SEC's sample comment letters and other disclosure guidance continue to be important resources for considerations applicable to the geopolitical environment and macroeconomic conditions impacting registrants. Even though the specific events that are driving uncertainty may change, the considerations discussed in these letters continue to be relevant. Importantly, disclosures should continue to evolve with each periodic filing and the impacts of different events or economic factors should be discussed separately within MD&A.

SEC registrants may need to update their disclosures related to quantitative and qualitative market risk — required by Item 305 of Regulation S-K — given the rapid rise in interest rates over the past year. Many companies have made changes to their liquidity, cash and risk management practices to address the higher interest rate environment. The SEC's FAQ on the quantitative and qualitative market risk disclosure rules is a helpful resource as companies update their disclosure.

Assessing assets for impairment continues to be a key area of focus. For goodwill, forewarning disclosures may be appropriate when there is potential for an impairment in the future. Section 9510 of the SEC Division of Corporation Finance's Financial Reporting Manual is a helpful resource on this topic, as it outlines considerations for companies when goodwill is not yet considered to be impaired but may be at risk in the future.

New SEC disclosure requirements

The SEC recently issued new rules on cybersecurity, executive incentive compensation clawbacks and share repurchases, each of which introduces new disclosure requirements.

The cybersecurity rule becomes effective December 18 and requires Form 8-K reporting of material cybersecurity incidents and disclosure on an annual basis of material information regarding a registrant's cybersecurity risk management, strategy, and governance. For more details, see our publication: In brief, SEC adopts cybersecurity disclosure rules.

The new rule relating to the clawback of erroneously awarded incentive-based compensation requires listed issuers to file their recovery policy as an exhibit to their annual reports beginning with the 2023 annual report for calendar-year-end registrants. Annual reports should also include new cover page disclosures and disclosures of any actions the company has taken pursuant to its recovery policies. For more details, see our publication: In depth, SEC adopts executive incentive compensation clawback rules.

Lastly, the share repurchase rule would expand existing share repurchase disclosure requirements to require separate disclosure of daily repurchases as well as additional information regarding repurchases for quarterly and annual reports. This rule was originally effective for fiscal quarters beginning on or after October 1, 2023; however, on November 22, the SEC issued an order that postpones the effective date in light of a recent appeals court ruling. Registrants should stay tuned for further developments. For more details, see our publication: In brief, SEC postpones effective date of share repurchase disclosure rule.

Disclosure requirements for recently issued accounting standards

SAB 74 provides guidance on disclosure requirements when a new accounting standard has been issued but is not yet effective. With significant new standards on segments, income tax disclosures and crypto assets released or expected to be released late in 2023, TMT companies may not have completed a comprehensive assessment of the impact of adoption. In this situation, registrants may initially disclose that they are assessing the impact of the new guidance and provide more detailed disclosures in future filings. If a recently issued standard is not expected to materially affect the financial statements, companies may decide to disclose that the new standard was issued, and its adoption will not have a material impact.

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 TMT 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 include amounts 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 non-legal reasons why a company restricts cash and cash equivalents; 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, restricted cash and restricted cash equivalents presented on the statement of cash flows to the amounts presented 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.

Income taxes: Current and near-term considerations

Accounting for income taxes is always a hot topic, but it has been even more of an area of focus this year given recent legislative developments, including the enactment of international legislation to implement Pillar Two global minimum taxes. TMT companies should also continue to monitor developments closely, as they could impact 2023 accounting.

Assessing the realizability of deferred tax assets

The assessment of the realizability of deferred tax assets and the adequacy of the related valuation allowance continues to be a focus amidst uncertainty in the economic environment. When assessing the realizability of deferred tax assets each reporting period, ASC 740, Income taxes, 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. Subsequent events can also impact the analysis. Companies should evaluate events that occur after the balance sheet date but before the financial statements are issued for any potential impact on their valuation allowance assessment. 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.

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

US legislative developments

In the past year, several US legislative developments have occurred that may impact a company's income tax accounting.

- Notice 2023-63 provides guidance on research and development capitalization under Section 174 of the Internal Revenue Code. For more information, see our publication: In brief, IRS Notice provides guidance on Section 174 capitalization; questions remain.
- Notice 2023-55 relates to foreign tax credits and provides temporary relief in determining whether a foreign income tax is creditable. For more information, see our publication: In brief, IRS issues temporary foreign tax credit relief.
- Notice 2023-64 provides additional guidance on the application of the corporate alternative minimum tax (CAMT) established by the Inflation Reduction Act. For more information, see our publication: In brief, Interim CAMT guidance on key issues.

TMT companies should also be on the lookout for other tax developments affecting the current year financial statements that may arise before the end of 2023.

Pillar Two global minimum tax

The Pillar Two global minimum tax is here and enactment of tax legislation around the world is underway. 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. The accounting impact of newly enacted tax laws based on the Pillar Two rules will occur when they become effective, which will generally be in 2024. However, companies should evaluate whether they should provide disclosure in MD&A in 2023 regarding the expected impact of the enacted tax laws on their business and financial statements. Companies will need to estimate their incremental tax liability (top-up tax) as part of their 2024 annual effective tax rate in the first quarter. Unlike many current tax systems, the Pillar Two minimum tax is determined based on financial reporting results reported in a company's consolidated financial statements, with certain modifications. This will result in a complex set of calculations that likely require new processes, controls, and systems. Among other considerations, a company will need to maintain separate books and records for each jurisdiction — potentially for each consolidated subsidiary — using the accounting framework of the Group's parent entity (US GAAP for most US-headquartered companies).

Learn more about how TMT companies can navigate this new fiscal landscape in our recent article, How TMT CFOs can prepare for Pillar Two.

Breaking new ground: Accounting for Inflation Reduction Act credits

With the latest estimates of Inflation Reduction Act (IRA) credits totaling more than $650 billion over the next 10 years, many TMT companies will be looking to reduce their tax liabilities by gaining access to that pool of credits. For some entities, that access will come through generating credits that they can (1) use on their own, (2) elect to receive as a direct payment from the government (available for a small number of credits) if they do not have sufficient tax liability to use the credits, or (3) sell to a third party if the credits are transferable under the law. For other entities whose operations do not lend themselves to generating credits, they may be looking to buy transferable credits or invest in flowthrough entities (e.g., LLCs or partnerships) that generate credits.

Whether an entity is generating, selling or buying credits, or investing in entities that generate credits, there is little guidance that directly addresses the accounting for these activities under US GAAP. As a result, there are many areas requiring judgment, and companies may need to develop accounting policies for transactions that may have limited or no precedent. For more on how to approach accounting for these novel transactions, listen to our podcast, Talking ESG: Accounting for IRA tax credits and read our publication: In depth, Accounting for Inflation Reduction Act energy incentives.

Final standards issued on segment reporting, crypto assets and income taxes.

As expected, the FASB issued final standards this quarter on segment reporting, crypto assets and income tax disclosures.

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.

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 requires 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 are also 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 is 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.

Income tax disclosures

Before 2023 comes to a close, 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 is 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 our publication, FASB issues guidance on income tax disclosures.

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 might be 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.

Regulatory update

On the regulatory front, we provide an update on sustainability reporting and the most recent trends in SEC comment letters for TMT companies.

Developments in sustainability reporting in the US and abroad

This quarter's most significant development in sustainability reporting was in the US, and it's not the SEC's long-awaited climate disclosure rule. California has issued three new laws — impacting TMT companies beyond just those headquartered in California — poised to change the US climate reporting landscape.

California climate disclosure bills

In October 2023, California Governor Gavin Newsom signed three landmark climate disclosure bills into law that will require (1) information about certain emissions claims and the sale and use of carbon offsets (AB 1305), (2) greenhouse gas (GHG) emissions reporting in compliance with the GHG Protocol (SB 253), and (3) climate-related financial risk reporting in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) (SB 261). Both the GHG Protocol and TCFD requirements should be familiar to companies given their reference in the "big three" sustainability frameworks. The requirements apply to both public and private companies with business activities in California. The earliest reporting is required by AB 1305, with information required to be posted to a company's website as soon as the bill becomes effective on January 1, 2024. SB 253 requires annual reporting of scope 1 and scope 2 emissions in 2026 (on prior year information) and scope 3 emissions in 2027, while SB 261 requires biennial reporting of the TCFD information beginning on or before January 1, 2026. For more details, read our publication: In the loop, California's not waiting for the SEC's climate disclosure rules.

Corporate Sustainability Reporting Directive (CSRD)

The 12 European Sustainability Reporting Standards (ESRS) for CSRD reporting are now final as the two-month scrutiny period from the European Parliament and Council of the European Union ended in October 2023. Also in October, the European Commission adopted a delegated act that would increase the asset and net turnover (revenue) thresholds used to determine entities in scope of CSRD by 25% to account for inflation, potentially decreasing the number of companies in scope. The delegated act will now face scrutiny from the European Parliament and Council of the European Union (for two months with a possible two-month extension) before going into effect. Further, the European Commission published a proposal, subject to approvals through the ordinary legislative procedure, to delay the sector standards and non-EU dedicated standards from the planned adoption date of 2024 to 2026; however, there is no proposed change to the required reporting dates. Finally, the European Financial Reporting Advisory Group (EFRAG) is targeting to release draft implementation guidance later this month related to the double materiality and value chain assessments for public comment. For more details about the CSRD, read our publications, Take the next step – decide how to report under CSRD, and Worldwide impact of CSRD - are you ready?.

International Sustainability Standards Board (ISSB)

Last quarter, we reported that the ISSB issued its first two IFRS® Sustainability Disclosure Standards covering general requirements (IFRS S1) and climate (IFRS S2). In October 2023, Brazil announced that the standards will be incorporated into the Brazilian regulatory framework, progressing from voluntary application in 2024 to mandatory application in 2026. In addition, the Australian Accounting Standards Board (AASB) has released an exposure draft of its climate disclosure standards based on the IFRS Sustainability Disclosure Standards. Other countries around the world are also evaluating adoption, and we expect this trend to accelerate now that the standards are final. For more information, read our publication: In depth, IFRS Sustainability Disclosure Standards – Guidance, insights and where to begin.

For more information

For details about how the sustainability reporting frameworks of the European Commission and ISSB compare to the SEC's proposed climate rule, including select commentary on the California climate disclosure bills, refer to our updated publication: In the loop, Navigating the ESG landscape.

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 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 September 30, 2023, are:

- **Non-Generally Accepted Accounting Principles (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.

In November, we kicked off our **2023 SEC comment letter trends** podcast series. Listen in for the latest themes in comment letters from the SEC's Division of Corporation Finance.

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 327,000 professionals in 155 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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