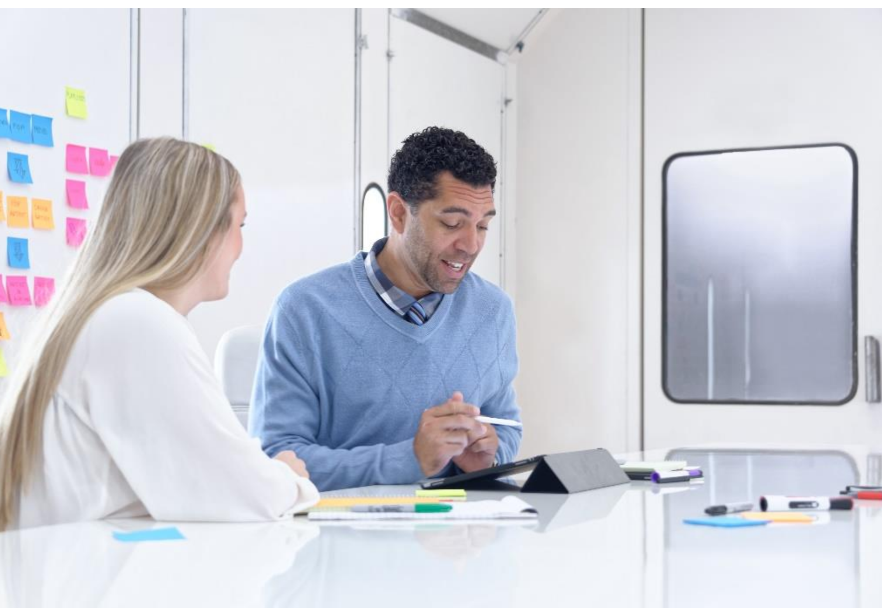
TMT Sector Game Changers

A biannual report on new accounting and reporting trends – June 2018 edition



TMT Sector Game Changers is a biannual report highlighting new accounting and reporting trends affecting the Technology, Media and Telecommunications (TMT) industries, some of the most dynamic and competitive segments of today's economy. It's designed to help you stay informed and ahead of the curve amidst an ever-changing marketplace.

In this edition, we highlight M&A and capital market trends, new lease accounting rules, new revenue standard adoption trends, tax reform and the impact on non-GAAP measures, updates to cloud computing, disclosures of cybersecurity risks, and spotlight on the EU General Data Protection Regulation (GDPR).

TMT deals, IPOs and debt offerings

Despite uncertainties and speculation on how the market would respond to the new tax reform, and questions surrounding government regulation on cross-border deals, tariffs, and cybersecurity, the Technology, Media and Telecommunication sector continues to have an appetite to acquire premium content and enhance technological capabilities with a number of megadeals.

Conditions are in place for healthy M&A activity, with a combination of a positive economic cycle and an abundance of capital that should encourage companies to continue exploring deals, even with looming government decisions on certain megadeals facing antitrust trials.

Consistent with these trends, PwC analysis shows that deal volume has increased across TMT in 2018.

In the first quarter alone, Technology saw four deals over $5 billion and over 500 transactions in the quarter, with a focus on investments in small and early-stage companies and Software acquisitions leading the deal volume and value. General Dynamic's acquisition of CSRA for over $9.6B, represented the largest deal for the quarter.

In the Media and Telecommunications space, there were 244 deals in Q1 2018, the highest quarterly volume level for the last two years. Two deals greater than $5 billion in value were announced during Q1'18 with the largest deal being a group of investors led by Blackstone Group LP's investment in a 55% stake of Thomson Reuters' Financial & Risk business for $17.0B. Additionally, the recent ruling and close of the acquisition of Time Warner by AT&T for $85B could mean additional entertainment megadeals down the line.

Since January, we've also seen $6.1 billion across 7 initial public offerings within the sector, with a notable offering of DropBox's public filing that raised $756M, and debt issuance of $65.5 billion to support refinancings and acquisitions for 111 companies across all sectors.

On the venture capital front, investors deployed $21.1 billion to US VC-backed companies across 1,206 deals, up 4% in dollars and down 2% in deals from Q4 2017.

Q1 2018 was also a record quarter for Artificial Intelligence (AI) funding with total investments exceeding $1.9 billion, the highest ever with three AI mega-rounds in companies independently focusing on robotics process automation, autonomous vehicles, and predictive analytics.

Read more from PwC: Q1 '18 Media & Telecom Deal Insights, Q1 '18 Tech Deal Insights, Q1 '18 Moneytree Report, Q1 '18 Deals Industry Insights and Capital Markets Update.

Leases

The clock is ticking down to when the new accounting standard for leasing comes into effect. Read executive level insights into the new lease accounting rules through our *In the loop* series and gain a technical perspective into the leasing standard's requirements with our *In depth* publications specific to the TMT sector. Also, see our video library on CFOdirect.com for additional guidance, including the following recent videos.

Read more from PwC: In depth: Technology industry supplement to leasing standard and Telecommunications industry supplement to leasing standard.

Leasing - Accounting for variable lease payments

This video discusses the accounting for variable lease payments, including what constitutes a variable lease payment as well as when and how they impact the measurement and classification of a lease. The video also addresses how to account for changes in variable lease payments.

Leasing - Discount rate for the lease liability

This video contains perspectives on the impact discount rates have on lease accounting, specifically on the liability related to the right to use asset. It also covers the definition of the incremental borrowing rate, including changes to the definition under ASC 842. Lastly, it provides insights on how to evaluate the term and also assess what can be considered as collateral, both of which are factors impacting the determination of the incremental borrowing rate.

Market and reporting trends from implementing the new revenue standard

Most calendar year public business entities have adopted the new revenue standard and are now focusing on "Day 2" strategies to improve business operations, reduce risk and realize greater value from their approach to revenue recognition.

PwC conducted an online survey in late April and early May 2018 to find out how companies are coping with the implementation of the revenue standard. More than 600 executives from a wide range of industries responded, and some highlights are shared below.

What the market is saying…

Where are public and non-public companies on their adoption journey?

19%

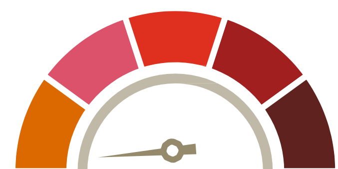
of **public companies are still implementing** the new revenue standard

40%

of **non-public** companies are **not yet done assessing** the impact

36%

had or expected to make significant or moderate **system changes** to enable adoption of ASC 606

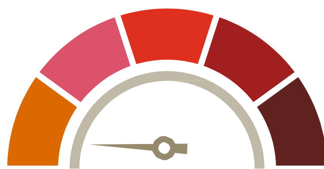


6%

Expect a **fully automated RMS** solution as of the effective date

55%

Expect **less than half** of the revenue management solution will be **manual**

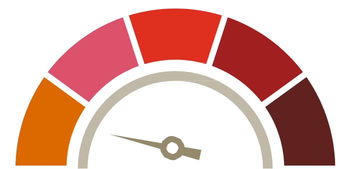


10%

Will have a **completely manual** solution

33%

of public companies reported having **6+ FTEs focused on implementation…**



15%

…have more than **10 FTEs**

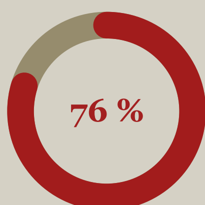
Source: PwC 2018 Accounting Change Survey

Read more from PwC: Refer to CFOdirect.com for the results of the survey and take a deeper dive into the data with our accounting change survey data explorer to find out how companies are coping with revenue recognition, leasing and hedge accounting transition experiences. You can also learn how to automate revenue recognition, improve operations, reduce risk and realize greater value by visiting Beyond ASC 606 compliance.

New revenue standard – transition and disclosure benchmarking

We reviewed the public filing of 50 companies in the TMT sector that have adopted the new revenue standard to identify trends in policy elections and disclosures and summarized our key findings below.

Key Findings:



Method of adoption

Which transition method did the company apply?

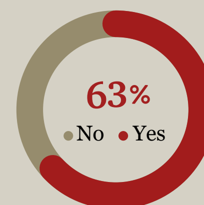
24% Full retrospective

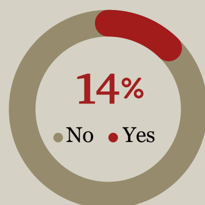
76% Modified retrospective

Quantitative SAB 74 disclosures

Did the company include quantitative impact of the new revenue standard in its SAB 74 disclosure prior to adoption?

63% of companies reviewed disclosed the quantitative impact of the adoption of the new revenue standard in the annual report for the year just prior to adoption





Item 4 (Internal controls) disclosure

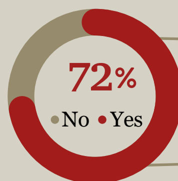
Did the company disclose a material change in internal control related to the new standard?

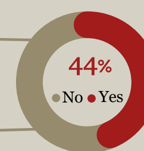
Of the companies reviewed only **14%** disclosed a material change in internal controls as a result of the adoption of the new revenue standard

Costs to obtain a contract

Does the company capitalize costs to obtain a contract?

Of the companies that capitalize costs, how many separate into ST/LT classification?





Learn more from PwC: Listen to the replay of our TMT industry executive webcast Q2 2018.

Tax reform

Under SAB 118, companies are permitted to account for the impacts of tax reform on a provisional basis. Companies in the TMT sector were largely impacted by the toll charge and remeasurement of deferred taxes as a result of the rate reduction. Based on initial observations of public companies' Q1 filings, many companies continue to consider the enactment date impacts as provisional. As companies start to finalize their accounting for impacts in subsequent periods, it is important to consider how any changes in their provisional estimates impact their non-GAAP disclosures outside of the financial statements.

Companies considering adjusting for items in non-GAAP measures should consistently make all such adjustments related to tax reform and not pick and choose which items they want to include if all are expected to have a one-time impact. Registrants that make these adjustments to measures for the period that includes the enactment date also should make similar adjustments to non-GAAP measures for subsequent periods.

Effective February 14, 2018, the FASB issued *ASU 2018-02 Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income,* which permits companies to reclassify the disproportionate tax effects in accumulated other comprehensive income (AOCI) caused by the tax reform ("stranded tax effects") to retained earnings. The new guidance includes several required disclosures, including a description of the accounting policy for releasing disproportionate income tax effects from AOCI. This disclosure will be an ongoing disclosure and is not specific to stranded tax effects resulting from the 2017 Act. Companies that elect to reclassify the income tax effects of the 2017 Act must disclose in the period of adoption:

- A statement that an election was made to reclassify the income tax effects of the 2017 Act from AOCI to retained earnings.
- A description of other income tax effects related to the application of the 2017 Act that were reclassified from AOCI to retained earnings, if any.

A company that does not elect to reclassify the income tax effects of the 2017 Act must disclose in the period of adoption that they did not reclassify the income tax effects of the 2017 Act from AOCI to retained earnings. The guidance is effective for all companies for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Public business entities may early adopt the guidance for financial statements that have not yet been issued. All other entities may early adopt the guidance for financial statements that have not yet been made available for issuance.

Read more from PwC: *In depth – FASB addresses stranded tax effects in AOCI caused by tax reform*. You can also learn more on how US companies are spreading their tax savings across growth initiatives from our survey we conducted. See CFO.direct US tax reform: 2018 survey of the C-Suite.

Accounting for cloud computing implementation costs

In June 2018, the Emerging Issues Task Force ("EITF") reached a final consensus that implementation costs associated with cloud computing arrangements that are considered a service contract should be evaluated for capitalization using the same model as if the cloud computing arrangement included a software license. The Task Force affirmed that capitalized implementation costs should be expensed over the term of the hosting arrangement, which includes periods covered by renewal options that are reasonably certain to be exercised. The Task Force also affirmed that an entity should apply the impairment model in ASC 350-40 with the clarification that the unit of accounting for abandonment is the asset related to a module of the hosting arrangement.

In response to comment letter feedback, the Task Force provided the following presentation guidance:

- An entity should present the capitalized implementation costs in the same line item that a prepayment for fees of the associated hosting arrangement would be presented;
- An entity should present the expense in the same line item as the fees associated with the hosting arrangement, which means the costs will generally be included in operating expense, not depreciation or amortization;
- An entity should classify the cash flows from capitalized implementation costs in the same manner as the cash flows for the fees paid for the associated hosting arrangement, which is generally in the operating section.

From a disclosure perspective, the Task Force decided that few new disclosures were needed above those already required under existing GAAP. The disclosures will include the nature of the hosting arrangement, quantitative information about the amounts capitalized, amortized and impaired during the period, and significant judgements made in applying the guidance.

Reporting entities will be allowed to choose between prospective and retrospective transition. For public entities, the effective date is fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. All other entities have an additional year. Early adoption is permitted.

Read more from PwC: For additional information in addition to other topics on the Task Force agenda in the June 2018 meeting, refer to the PwC EITF Observer.

Cybersecurity

In February 2018, the SEC issued interpretive guidance to assist companies with the preparation of cybersecurity risks and incidents disclosures. The new guidance does not change any of the SEC's rules, however does address two additional topics:

- Companies should assess whether they have sufficient disclosure controls and procedures in place to ensure that relevant information about cybersecurity risks and incidents are processed and reported to the appropriate personnel.
- Policies and procedures should be in place to prevent insider trading and companies should consider restrictions on trading while significant cyber incidents are investigated.

Through our online survey, we received responses from over 9,500 global executives in more than 75 industries, and summarized our key findings for how global business leaders strive to improve cyber and privacy risk management. Refer to our Global State of Information Security Survey 2018.

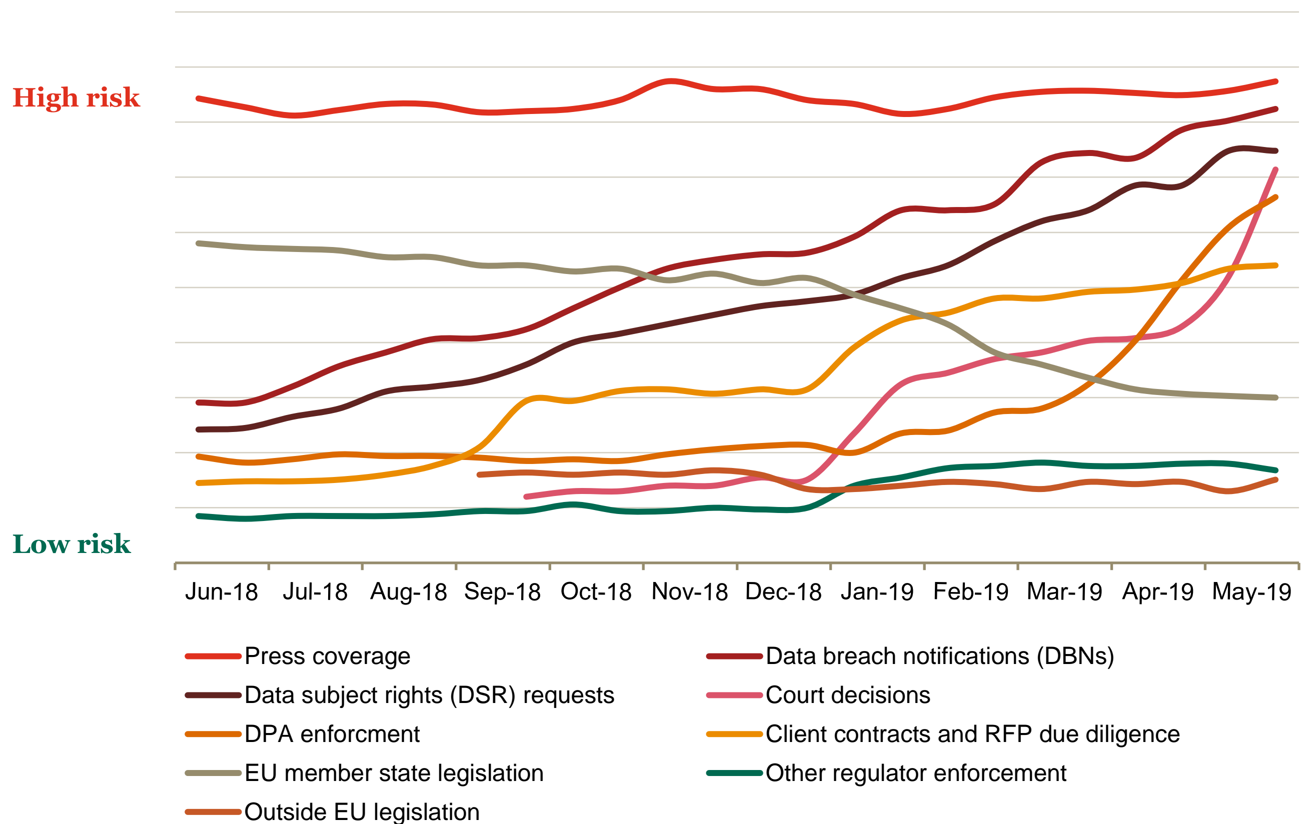
Read more from PwC: PwC In Brief - SEC issues interpretative guidance on cybersecurity disclosures and Boards of directors and cyber risk: the role of the CISO in avoiding a breakdown.

Spotlight on: EU GDPR – Is your company finding its second wind?

Over the past year, preparedness for the European Union's (EU) General Data Protection Regulation (GDPR) has been the white-hot priority for many US-based multinationals. Now that GDPR has come into force as of May 25, 2018, many organizations are finding themselves succumbing to compliance fatigue - looking to shift their energy and focus away from GDPR. This push to de-prioritize GDPR may prove to be premature and risky, especially for companies across the technology, media, and telecommunications sectors.

On day one of GDPR enforcement, some of the major technology companies found themselves on the receiving end of GDPR complaints totaling more than $9 billion in potential fines. Organizations are putting their vendors and business partners under the GDPR microscope, and actively divesting from companies who fail to demonstrate GDPR readiness. GDPR is not a one-time compliance hurdle, but rather the new table stakes for doing business in Europe.

GDPR in the external environment – The next 12 months



Multiple sources of GDPR risk will coverage into a gradually increasing crescendo over the next year.

Organizations will need to be able to demonstrate an actively managed GDPR program to safeguard their operations going forward. Given the increased stakes, where should organizations be focusing their energy now that GDPR is active and enforceable?

Monitor the regulatory aftershocks of GDPR

Savvy organizations will be vigilant to monitor and adapt to the downstream changes to regulation and consumer expectations caused by GDPR. One source of change is the newly established European Data Protection Board (EDPB), which is now the authority for updated GDPR guidance and clarifications with direct impact on how key aspects of the law are interpreted.

In addition, EU Member-States are authorized to deviate from GDPR language in certain circumstances through their own adopted legislation. The ripple effect of GDPR extends beyond the EU, as other nations stand to adopt similar regulatory requirements to achieve or retain an "adequacy" designation with the EU. The US is not immune to these changes either, as news of GDPR, combined with recent data privacy events and controversies, is increasing the pressure on legislatures to take action. Vermont and California are leading the charge for new regulation on privacy and data use, and the upcoming mid-term elections may encourage other state and Federal legislators to take action as well. Maintaining environmental awareness of these shifts in regulation and consumer expectations is emerging as a new top-of-mind priority for organizations pursuing a global, data-centric strategy.

Get to operational readiness for GDPR

While it may seem like an obvious priority, many organizations still find themselves midway through their journey to achieve initial compliance with GDPR. Fewer still have established the policies and procedures needed to operate an effective GDPR program on a go-forward basis. For example, a company with a suite of records of processing for its EU operations may be GDPR compliant today – but without the procedures in place to maintain and update these records the work is made stale and non-compliant in little time.

This "operationalization" of GDPR is paramount to being able to demonstrate compliance with the law – to the regulators, courts and new and existing business customers alike. Despite the missed deadline, organizations must now continue actively progressing down their GDPR roadmap.

Identify opportunities to drive efficiencies through technology and alternative resourcing strategies

Organizations that have achieved GDPR readiness are finding that identifying and securing adequate resources and talent to operate the program is bringing new challenges. In lieu of new privacy talent, many organizations are taking steps to automate and streamline their GDPR operations through technology enablement. Using a combination of governance, risk, and compliance (GRC) tools and data management technology, companies are identifying ways to automate workflows, increase effectiveness and efficiency, and manage records, policies, and data protection impact assessments in a centralized and demonstrable way.

Innovative resourcing strategies are also being pursued, with companies investing in co-source or staff augmentation support from service providers to operate their GDPR program. Through this approach, specialist talent can be scaled up or down to meet a company's GDPR across vendor risk management, data protection impact assessments, data subject rights, and more. Some companies are also outsourcing their DPO role.

Given these factors, and as the diverse risks of GDPR are set to crescendo over the next year, companies in the TMT sector should maintain with GDPR momentum and safeguard ongoing executive leadership support and buy-in.

If you'd like to have a discussion about GDPR mobilization, resourcing, or technology enablement, contact Toby Spry, PwC Privacy & Consumer Protection Principal (toby.a.spry@pwc.com), or Jay Cline, PwC US Privacy & Consumer Protection Leader (jay.cline@pwc.com).

About PwC's TMT industry practice

PwC's TMT practice strives to help business leaders in the Technology, Media and Telecommunications industries manage their complex businesses and capitalize on new windows of opportunity.

With offices in 158 countries and more than 236,000 people, we help organizations and individuals create the value they're looking for by delivering quality in assurance, tax, and advisory services. Visit our website at: www.pwc.com/us/tmt

Let's talk

For a deeper discussion on the content included in this edition of TMT Sector Game Changers or other challenges, please reach out to any of our TMT leaders to discuss. We're here to help.

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