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TMT: Economic uncertainty and financial reporting

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It’s not business as usual: Economic uncertainty and financial reporting

Continuing economic uncertainty — rising interest rates, inflation, recession fears — means that reporting season is not business as usual.

The aftereffects of the global pandemic and the ongoing geopolitical unrest are reverberating throughout the economy, changing consumers’ spending habits and disrupting the supply chain.

The current economic environment makes accounting estimates and forecasting cash flow even more difficult than they already are.

Preparers should be mindful of having the right resources lined up to address this year’s reporting challenges. The current economic trends are likely to make accounting judgments more complicated and may require more resources than the financial reporting function has needed in the past.

These concerns cut across industry and geography, regardless of company size. Additional attention should be given to asset impairment analyses and other accounting areas requiring significant judgment.

Considerations for technology, media & telecommunications (TMT) companies

The economy is the top concern for tech CEOs. About 85% of them believe a recession is likely in the next year, according to the KPMG U.S. Technology Industry CEO Outlook. Tech layoffs and hiring freezes are the headline news in the sector, and the semiconductor supply chain is still experiencing challenges, although most executives believe the shortage will ease in 2023.

“In today’s environment, tech companies are being challenged to do more with less and to maximize efficiencies, which can affect financial reporting,” said **Janel Riley**, KPMG National Audit Industry Leader – Technology. “Being able to take advantage of automation, new technologies and new ways of working will not only be a business imperative but also a competitive advantage.”

Like the tech sector, the media industry is seeing a continuing trend of layoffs. Additionally, streaming services and entertainment are often the first to be cut from consumers’ budgets in a downturn. Telecom, on the other hand, may be in relatively better shape than other sectors as consumers prioritize mobile and internet services over some other recurring bills.

“Looking toward the future, the effects of cable cord-cutting may lead to impairment charges for some telecom companies,” said **Frank Albarella Jr.**, KPMG National Audit Industry Leader – Media and Telecom. “Additionally, calculating the anticipated growth of streaming involves judgment, and companies may need to reassess their strategies if subscriptions decline, particularly with the market becoming increasingly saturated.”

Know before you go

Regardless of the industry, preparers should ask:

- what aspects of financial reporting are impacted if the entity has experienced a prolonged decrease in its share price and how impairment testing is affected;
- whether management's projections are consistent with expectations in the current environment;
- how their business has been impacted by inflation;
- whether there are other financial challenges their customers may be facing, and the possible impacts on demand; and
- how the rising interest rate environment impacts discount rates used in impairment testing and in fair value calculations more broadly.

Inflation affects the cost of doing business and companies may not be able to increase prices to customers enough to offset rising inflation, putting pressure on forecasted profit margins. Margins are often key inputs into companies' long-lived asset and goodwill impairment testing.

The fair value estimates inherent in goodwill and other asset impairment analyses can be sensitive to discount rates, so a rising interest rate environment can have very significant impacts to some companies.

Monitoring for triggering events is a continuous assessment. So even if an annual impairment test has already been performed, another may be necessary as conditions evolve.

In response to economic uncertainty, companies may also modify revenue contracts to reduce minimum quantity commitments, adjust delivery schedules for certain goods or services, change the price of those goods or services, or extend payment terms. These modifications may require companies to assess that change under the specific contract modification guidance for how they recognize revenue.

Furthermore, companies may be adjusting share-based payment arrangements to better align with the current macroeconomic environment to motivate employee behavior toward company goals. For example, an original sales target may no longer be attainable due to economic headwinds, and a company may lower that threshold under the compensation arrangement to make it more likely that its employees can vest in the awards. These modifications can have significant accounting and reporting consequences and should be evaluated carefully, ideally before any changes are implemented.

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