



Insights

by Capital Markets & Accounting Advisory Services

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Topical issues to consider when preparing 31 December 2022 financial statements

Introduction

In this Insights, we give an overview of the accounting implications of the following topical issues that entities with 31 December 2022 year end might consider when preparing their financial statements:

1. Impacts of rising inflation and interest rates
2. Hyperinflationary economies
3. Lessor forgiveness of lease payments
4. Impairment reviews of non-financial assets
5. Debt restructurings
6. Climate change
7. Russian invasion of Ukraine and Russian sanctions

There are a number of narrow-scope amendments and annual improvements on MFRS effective 1 January 2022 as highlighted in [Appendix I](#) at the end of this publication.

We have also updated the [MFRS disclosure checklist](#) for 31 December 2022 year end taking into account MFRS and IC Interpretations issued or amended by the Malaysian Accounting Standards Board (“MASB”) up to 15 December 2022.



1. Impacts of rising inflation and interest rates

Many entities are experiencing the effect of rising inflation and interest rates which touch all aspects of an entity's business including increasing costs such as raw materials and wages, changes in customer behaviour and credit risk, negotiations of contract terms and investment and financing decisions. In turn, the effect on the financial statements is likely to be equally widespread, and companies need to consider the accounting implications for the 31 December 2022 year-end.

Rising inflation and interest rates will affect fair value measurements, expected future cash flows estimates, discount rates used to determine present value of cash flows, impairment indicators and impairment tests. Some of the key MFRS accounting standards entities might consider in this regard include:

- MFRS 9 "Financial Instruments" - the impact on expected credit losses.
- MFRS 13 "Fair value measurement" - the impact on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (e.g. impact on market prices for investment properties).
- MFRS 15 "Revenue from contracts with customers" - the impact on contracts that include a significant financing component at inception.
- MFRS 112 "Income taxes" - the impact on forecasts of future taxable income.
- MFRS 119 "Employee benefits" - in particular the impact on measuring defined benefit pension liabilities.
- MFRS 121 "The effects of changes in foreign exchange rates" - the impact on volatility of exchange rates when assessing whether using an average rate is appropriate.
- MFRS 123 "Borrowing costs" - the potential increase in capitalised borrowing costs.
- MFRS 136 "Impairment of assets" - the impact on impairment indicators as well as cash flows and discount rates (see Section 4 below on impairment reviews of non-financial assets).
- MFRS 137 "Provisions, contingent liabilities and contingent assets" - the impact of discount rates and inflation estimates on provisions including decommissioning obligations, and the recognition and measurement of onerous contracts.

Rising inflation and interest rates may cause significant estimation uncertainty for both short and long duration assets and liabilities. Entities may therefore also need to consider new or expanded disclosures in this area. As a reminder, MFRS 101 "Presentation of financial statements" requires disclosures about sources of significant estimation uncertainty. This includes disclosing information about assumptions that could result in material adjustments to the carrying amount of assets and liabilities within the next financial year, and how sensitive those carrying amounts are to those assumptions. MFRS 101 also requires disclosures about judgements that have a significant effect on the financial statements.

Attention should also be given to all the disclosures for financial instruments in accordance with MFRS 7 "Financial Instruments: Disclosures", in particular those relating to liquidity and sensitivity.

Read further in our publication [*Snapshot: Navigating MFRS in periods of rising inflation*](#).



2. Hyperinflationary economies

Based on the current global economic environment and following the deteriorating economic condition and currency controls, Turkey and Ethiopia are now considered to be hyperinflationary for the purpose of MFRS 129 “Financial reporting in hyperinflationary economies” for reporting periods ending on or after 31 December 2022.

Paragraph 43 of MFRS 121 requires the financial statements of a subsidiary that has the functional currency of a hyperinflationary economy to be restated in accordance with MFRS 129 before being included in the consolidated financial statements. Comparative amounts of these subsidiaries that were presented previously in the parent’s stable currency are not restated.

MFRS 129 requires financial statements of an entity whose functional currency is the currency of a hyperinflationary country to be restated into the measuring unit current at the end of the reporting period. Therefore, transactions in 2022 and non-monetary balances at the end of the period would be restated to reflect a price index that is current at the balance sheet date.

The IMF World Economic Outlook report released in October 2022 provides updated data in respect of current and projected levels of inflation and one of the most significant changes from the updates relates to Sri Lanka, which, although it is not hyper-inflationary in 2022, should be kept under review. Read [PwC In brief INT2022-19](#) for more information on hyperinflationary economies as at 31 December 2022.



3. Lessor forgiveness of lease payments

In October 2022, the International Accounting Standards Board (“IASB”) finalised the agenda decision (“AD”) approved by the IFRS Interpretation Committee (“IFRS IC”) on “Lessor forgiveness of lease payments (IFRS 9 and IFRS 16)”. The AD addresses the accounting from the perspective of the lessor, and in particular:

- How the expected credit loss model in IFRS 9 should be applied to the operating lease receivable when the lessor expects to forgive payments due from the lessee under the lease contract before the rent concession is granted.
- Whether to apply the derecognition requirements in IFRS 9 or the lease modification requirements in IFRS 16 “Leases” when accounting for the rent concession.

Read our [Snapshot](#) for further details of the AD. As explained in our [Snapshot: The Importance of IFRIC Agenda Decisions in MFRS Financial Reporting](#), in view that MFRS is fully converged with IFRS, Malaysian entities should also consider the IFRIC AD and implement any necessary accounting policy changes on a timely basis when preparing the MFRS financial statements.



4. Impairment reviews of non-financial assets

Impairment is an ongoing area of concern for many entities. Entities holding significant amounts of goodwill and intangibles are at greater risk of potential impairment under the current challenging environment. The key points in impairment testing are:

- For the value-in-use (“VIU”) model, key assumptions should stand up against external market data. Cash flow growth assumptions should be comparable with up-to-date economic forecasts. The fair value less costs of disposal (“FVLCD”) model, which is a post-tax model, must use market participant assumptions, rather than those of management.
- In times of greater uncertainty, it is likely to be easier to incorporate these uncertainties in impairment testing by using multiple cash-flow scenarios and applying relative probability weightings to derive a weighted average set of cash flows rather than using a single cash flow forecast and attempting to risk adjust the discount rate to reflect the higher degree of uncertainty in the environment.
- MFRS 136 requires that the VIU model uses pre-tax cash flows discounted using a pre-tax discount rate. In practice, post-tax discount rates and cash flows are used which theoretically give the same answer but the need to consider deferred taxes makes this very complicated. Therefore if a post-tax VIU model results in a ‘near miss’ the next step should be to determine FVLCD”).
- Rising costs are becoming a noticeable issue in many countries that have not suffered significant inflation for many years so it is worth noting that a VIU calculation should incorporate specific price changes as well the effect of general inflation either by:
 - (a) estimating future cash flows in real terms (i.e. excluding the effect of general inflation but including the effect of specific price changes) and discounting them at a rate that excludes the effect of general inflation or
 - (b) estimating future cash flows in nominal terms (i.e. including the effect of general inflation) and discounting them at a rate that includes the effects of general inflation.

Where inflation assumptions could have a material impact on the financial statements, additional disclosures may be required to explain how inflation has been incorporated into the VIU.

- In assessing for impairment, the carrying value should be determined on a consistent basis as the recoverable amount. For example:
 - Where the recoverable amount is determined using the FVLCD model, the carrying amount tested should include current and deferred tax assets / liabilities (but exclude deferred tax assets for existing tax losses, because these are generally not part of the CGU).
 - Where the VIU model (i.e. pre-tax) is applied, deferred tax assets should not be added to the carrying value and deferred tax liabilities should not be deducted (i.e. are not included in the carrying amount of the CGU). This could result in the carrying value for VIU being higher than the carrying value for FVLCD. However, in situations where there is significant deferred tax upfront, MFRS 136 VIU test may not be the most appropriate method to determine the recoverable amount of a CGU.



4. Impairment reviews of non-financial assets (continued)

The key points in impairment testing are (continued):

- If impairment of goodwill is identified at the group level this will most likely trigger an impairment review of the parent entity's investment in the relevant subsidiaries in the parent's separate financial statements.
 - VIU of an investment in a subsidiary would be determined by the present value ("PV") of expected dividend receipts.
 - The PV of the estimated post tax cash flows from the subsidiary's underlying assets might be used as a proxy for this if the subsidiary has no debt. Otherwise, the PV of expected cash flows should be reduced by the fair value of outstanding debt (both external and inter-company), in order to determine the net amount available for distribution.
- With the implementation of MFRS 16, there have been some effects on accounting for impairments of non-financial assets under MFRS 136, which includes right of use ("ROU") assets. Entities might not have taken account of these changes if there were previously no impairment indicators in the cash-generating units ("CGUs") to which the ROU assets related. Entities should ensure that they consider the changes to the impairment testing as a result of MFRS 16 if the CGUs include ROU assets.

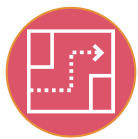
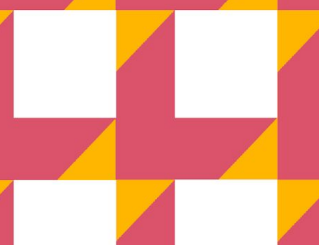
Key disclosure requirements

The required disclosures in MFRS 136 are extensive. MFRS 136 requires disclosure of the key assumptions (those that the recoverable amount is most sensitive to) and related sensitivity analysis. Paragraph 25 of MFRS 101 also requires disclosure of critical accounting judgements and of key sources of estimation uncertainty.

Where a reasonable possible change in key assumptions would reduce the headroom (excess of the recoverable amount over the carrying amount) of a CGU to nil, entity is required to disclose this headroom:

- Where the headroom is sensitive to changes in key assumptions, an entity would need to disclose the specific changes in assumptions that would erode headroom to nil (+/- x% in sales growth or discount rates).
- However, in cases where no reasonably possible change would either erode headroom for CGUs when testing goodwill or give rise to a material adjustment to any carrying value in the next year, entities should take care that additional sensitivity disclosures do not give the wrong impression or become confusing to users.

Given the increased uncertainty and volatility in many markets at present, the range of reasonably possible changes has widened which means that more extensive impairment disclosures will typically be required.



4. Impairment reviews of non-financial assets (continued)

Key disclosure requirements (continued)

Key assumptions and wider ranging assumptions covering multiple CGUs should be clearly disclosed. Where material, assumptions specific to each CGU should be identified. Changes to assumptions used, such as the discount rate, which has changed significantly from the previous year should be explained.

Furthermore, in an impairment case, the entities would need to clearly disclose what the cause of the impairment was and whether this is based on external data or changes in the entity's own estimates. An entity with a material impairment loss or reversal additionally need to disclose the recoverable amount of the asset(s) or CGU(s) affected [MFRS 136 para 130(e)].

Whilst the long-term growth rate used to extrapolate cash flow projections (to estimate a terminal value) and the pre-tax discount rate are important; they are not 'key assumptions' on which the cash flow projections for the period covered by the most recent budgets or forecasts are based. Therefore, attention should also be paid to the discrete growth rate assumptions applied to the cash flows projected to occur before the terminal period. Accounting policy disclosures should always be consistent with the basis used in the accounting impairment test.





5. Debt restructurings

We continue to see questions on the restructuring of issued debt instruments (e.g. loan facilities or bond financing). This is a complex area of accounting which requires significant judgement. Some of the key accounting considerations are summarised below:

- *Determining whether the new and old debt have substantially different terms* – applying MFRS 9, when a financial liability is exchanged or its terms are modified but the liability remains between the same borrower and the same lender, it is necessary to assess if the terms are substantially different. See our [Snapshot](#) on type of fees to be included in the MFRS 9 '10% test'. If the terms are substantially different, the transaction should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.
- *Treatment of gain or loss on modification of debt* – when a financial liability measured at amortised cost is modified without this resulting in derecognition, a gain or loss should be recognised immediately in profit or loss. The gain or loss is calculated as the difference between the original contractual cash flows and the modified cash flows discounted at the original effective interest rate.
- *Treatment of fees incurred as part of the renegotiation* – the fees should be recognised immediately or capitalised depending on whether the exchange of debt instruments or modification of terms is accounted for as an extinguishment or not.



6. Climate change

Climate-related risks are an important topic that might have an impact on an entity's operations and financial performance. MFRS does not explicitly address climate risk, but the principles that underlie various judgements and estimates made in the preparation of the financial statements will often incorporate climate risk factors.

Examples of specific areas entities should consider as climate issues become more significant include "green" loans (i.e. bonds/loans that are issued at an interest rate that is to a certain degree dependent on key performance indicators that are sustainability related), exchange traded climate credit schemes and estimates used in provisioning and recoverable amount calculations.

It is also important to note that MFRS 101 has an overarching disclosure requirement; to disclose information if that information is needed to enable investors to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance. In many cases, an entity's exposure to climate-related risks might not have changed significantly since its last annual reporting period. However, climate-related risks are becoming a more important topic for many users of financial statements. Therefore, in light of the current focus on, and impact of, climate change, entities should ensure that they have undertaken a rigorous assessment to ensure that all of the material information affecting the financial statements in this respect is provided.



6. Climate change (continued)

The IASB issued [educational material](#) contains a non-exhaustive list of examples regarding how climate risk might affect the measurement and disclosure requirements of various standards and the various paragraphs of those standards that might be referenced in determining how to incorporate such risks.

Entities should also ensure consistency between financial and non-financial reporting on key climate-related assumptions where such consistency is necessary for compliance with MFRS. For example, if the entity presents a separate sustainability report or management commentary and highlights specific climate related risks, the assumptions used in the financial statements' recognition, measurement, presentation and disclosure should be consistent with those disclosed in the sustainability reporting. For further information read [PwC In depth INT2021-11](#).



7. Russian invasion of Ukraine and Russian sanctions

The Russian invasion of Ukraine, alongside the imposition of international sanctions continue to have a pervasive economic impact, not only on businesses within Russia and Ukraine, but also globally where businesses engage in economic activities that might be affected by the recent developments. This necessitates careful consideration of the resulting accounting implications by entities who are affected by these developments.

For 31 December 2022 year ends, there is a need to consider a number of areas including (but not limited to):

- Russia's restricted access to foreign currency reserves and restriction of certain Russian banks' access to SWIFT
- Impairment of financial assets (such as loans, receivables and Russian bonds) as well as fair value measurement and hierarchy
- Impairment of non-financial assets
- Contingencies, onerous contracts and assessment of breaches of supply contracts to determine if an obligation exists
- Financing arrangements, including liquidity constraints and possible breaches of covenants
- Classification and availability of cash and cash equivalents which may now be restricted
- Foreign exchange exposure and translation of foreign currency transactions
- Level of influence or power over existing associates and subsidiaries within Russia and Ukraine
- Classification of businesses / operations as non-current assets held for sale
- Post balance sheet event considerations regarding measurement recognition and related disclosure for non-adjusting material events
- Going concern presentation and disclosure of Russia/Ukraine specific impacts on the primary financial statements and notes thereof
- Modification or termination of contracts with customers
- Change in settlement method of share-based payment award and accounting for other benefits given to employees.

For further information read [PwC In depth INT2022-05](#).



Appendix I

The following are amendments to MFRS newly applicable for companies with 31 December 2022 year ends:

- **Amendment to MFRS 16 “Leases” - Covid-19 related rent concessions beyond 31 June 2021**

This optional practical expedient allows lessees to account for rent holidays and temporary rent reductions in the same way as variable lease payments in the periods in which the condition that triggers the reduced payment occurs. This amendment extends the date of the practical expedient from 30 June 2021 to 30 June 2022. Read our [Snapshot](#) to find out more.

- **Amendments to MFRS 116 “Property, plant and equipment” - Proceeds before property, plant and equipment (“PPE”) is ready for intended use**

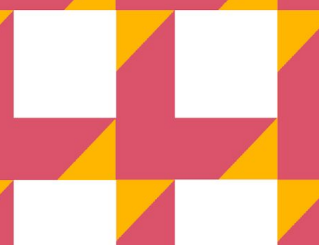
The amendments prohibit an entity from deducting from the cost of PPE amounts received from selling items produced while the entity is preparing the asset for its intended use. Instead, an entity will recognise such sales proceeds and related costs in profit or loss. Read our [Snapshot](#) to find out more.

- **Amendments to MFRS 137 “Provisions, contingent liabilities and contingent assets” - Onerous contracts: Cost of fulfilling a contract**

The amendments specify which costs an entity includes when assessing whether a contract will be loss-making. Read our [Snapshot](#) to find out more.

- **Amendments to MFRS 3 “Business combinations” - Reference to conceptual framework**

The amendments update a reference in MFRS 3 to the conceptual framework for financial reporting without changing the accounting requirements for business combinations.



Appendix I (continued)

The following are amendments to MFRS newly applicable for companies with 31 December 2022 year ends (continued):

- **Annual improvements of MFRSs 2018 - 2020**

(1) Amendment to MFRS 1 “First-time adoption of MFRS” - Subsidiary as first-time adopter

The amendment allows a subsidiary that adopts MFRS later than its parent to elect to measure cumulative translation differences for all its foreign operations based on the carrying amounts that would be included in the parent's consolidated financial statements.

(2) Amendment to Illustrative Example accompanying MFRS 16 - Lease incentives

The amendment removed the illustration on the reimbursement relating to leasehold improvements by the lessor to avoid potential confusion on whether the reimbursement would meet the definition of a lease incentive in MFRS 16.

(3) Amendment to MFRS 141 “Agriculture” - Taxation in fair value measurement

The amendment removed the requirement to exclude cash flows for taxation when measuring fair value to align with the requirements in MFRS 13.

(4) Amendment to MFRS 9 - Fees in the 10% test for derecognition of financial liabilities

This amendment will impact the result of the ‘10% test’ and accordingly affect the amount of the gain or loss recognised in the income statement. All companies, particularly those applying an existing policy of including fees paid to third parties in the ‘10% test’, will be impacted by this amendment. Read our [snapshot](#) to find out more.

Do you need further information on this topic?

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