



# Insights

by Capital Markets & Accounting Advisory Services (CMAAS)

August 2023

## Disclosure of material accounting policies (Amendments to MFRS 101 and MFRS Practice Statement 2)



### Overview of the amendments (effective for annual reporting periods beginning on or after 1 January 2023)

The amendment to MFRS 101 'Presentation of Financial Statements' requires companies to disclose their material accounting policy information rather than their significant accounting policies. Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements.

The amendment also clarifies the following:

- Accounting policy information is expected to be material if, without it, the users of the financial statements would be unable to understand other material information in the financial statements.
- Immaterial accounting policy information need not be disclosed. However, if it is disclosed, it should not obscure material accounting policy information.

Paragraph 117B of MFRS 101 provides illustrative examples of accounting policy information that is likely to be considered material to the entity's financial statements. To support the amendments to MFRS 101, [MFRS Practice Statement 2 'Making Materiality Judgements'](#) was also amended to provide guidance on how to apply the concept of materiality to accounting policy disclosures.



### Illustrative examples

This Insights illustrates how the amendments could be applied in the following examples:

1. Disclosures of accounting policies on revenue recognition.
2. Disclosures of accounting policies about leasing activities by a lessee; and
3. Disclosures of accounting policies for fixed-fee services contracts.

The list of examples above is not exhaustive and the same conclusions might not always be reached in different fact patterns.

If management has used significant judgments and assumptions in developing and/or applying the accounting policies, an entity would need to consider disclosing these as required by MFRS 101.



## Illustrative examples (continued)

### 1. Disclosures of accounting policies on revenue recognition

#### Background information

Entity G is a retailer of new cars. According to local law, Entity G is required to repair any damages to the car up until 12 months after delivery, to the extent that the damage relates to defects existing at delivery date ("assurance warranty"). Each car sold also includes an obligation for Entity G to perform specific services beyond the mandatory warranty requirements for a period of three years ("the service plan"). Entity G does not sell similar service plans separately, but the sales contracts for the cars explicitly identify which services are included. Entity G's competitors do not bundle such service plans into their sale of cars by default, but offer similar service plans as an optional add-on for an extra fee.

Customers are charged the total contract price upon delivery of the car, i.e. for the car itself and the service plan.

Entity G recognises revenue when, or as, it satisfies its performance obligations. It has identified two performance obligations in the contracts: (1) the car and (2) the service plan.

Consequently, Entity G allocates the transaction price to each performance obligation and recognises revenue, separately, as it satisfies each performance obligation.

Entity G determines that its performance obligation for a car is satisfied at the point in time when the car key is delivered to the customer (and at the same time recognises an obligation for the mandatory warranty). The performance obligation for the service plan is satisfied over the three-year service period.

At year-end 31 December 20X2, Entity G concluded that revenues from both car sales and service plans are material in its financial statements.

Entity G is preparing its financial statements for the year ended 31 December 20X2. Should accounting policy information on revenue recognition be disclosed?



## Illustrative examples (continued)

### 1. Disclosures of accounting policies on revenue recognition (continued)

**Analysis**

Entity G considers that:

- the accounting policies were unchanged during the year as compared to previous financial year;
- the accounting policies applied are not chosen from an available set of alternatives;
- accounting policies for revenue recognition are described in MFRS, and not developed by Entity G based on the principles set out in MFRS 108 'Accounting Policies, Changes in Accounting Estimates and Errors' in the absence of a specific MFRS that deals with a similar issue; and
- the accounting policies are not very complex.

However, Entity G assesses that the revenue amounts are material to the financial statements and that various areas of judgement have been used in applying the accounting policies, for example in [MFRS 101.117B(d)]:

- identification of performance obligations, in particular concluding that its service plans are distinct from the sale of the car even though they are not sold separately;
- determining if any significant financing component exists in the prepaid service plan;
- allocating the contract price to 2 distinct performance obligations; and
- determination of when the performance obligation for the service plans is satisfied.

Considering all facts and circumstances, to sufficiently understand the amounts presented, Entity G would likely assess and conclude that primary users of Entity G's financial statements might need information about how the accounting policies for revenue recognition have been applied by Entity G.

Hence, entity-specific information about accounting policies for revenue recognition would likely be disclosed [MFRS 101.117C], in addition to the disclosures of significant judgements made and other relevant disclosure requirements in MFRS 15.



## Illustrative examples (continued)

### 2. Disclosures of accounting policies about leasing activities by a lessee

#### Background information

Entity D, an investment property entity, owns 15 investment properties in the high-end area of its jurisdiction's capital.

The properties are leased out for periods up to, and never exceeding, ten years. Entity D has concluded that substantially all of the risk and rewards of the properties are retained, and has consequently classified them as operating leases in accordance with MFRS 16 'Leases'.

Entity D has outsourced the property management services for the entire portfolio of properties, and only a small administrative staff is employed. Entity D is headquartered at the 10th floor of one of its own properties. The headquarters are classified as owner-occupied property in the balance sheet, and measured at a revalued amount in accordance with MFRS 116 'Property, Plant and Equipment'.

Entity D has rented two cars for use by their CEO and CFO as part of their respective remuneration packages. The lease term on both contracts when entered into two years ago was five years.

In its previous financial statements, Entity D disclosed the following information about its leasing activities, when acting as a lessee:

*"The entity leases vehicles for fixed periods of three to five years, usually without extension options. None of the entity's contracts are determined to contain any non-lease components.*

*Lease terms are negotiated on an individual basis and contain different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.*

*The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, which is generally the case for leases in the entity, the incremental borrowing rate is used, being the rate that the entity would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.*

*To determine the incremental borrowing rate, the entity:*

- *where possible, uses recent third-party financing received by the entity as a starting point, adjusted to reflect changes in financing conditions since third-party financing was received;*
- *uses a build-up approach that starts with a risk-free interest rate adjusted for credit risk for leases held by Entity D, which does not have recent third-party financing; and*
- *makes adjustments specific to the lease, e.g. term and security.*



## Illustrative examples (continued)

### 2. Disclosures of accounting policies about leasing activities by a lessee (continued)

#### Background information (continued)

In its previous financial statements, Entity D disclosed the following information about its leasing activities, when acting as a lessee: (continued)

*If a readily observable amortising loan rate is available to the entity (through recent financing or market data) which has a similar payment profile to the lease, then the entity uses that rate as a starting point to determine the incremental borrowing rate.*

*The entity is exposed to potential future increases in variable lease payments based on an index or rate, which are not included in the lease liability until they take effect. When adjustments to lease payments based on an index or rate take effect, the lease liability is reassessed and adjusted against the right-of-use asset.*

*Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the entity is reasonably certain to exercise a purchase option, the right-of-use asset is depreciated over the underlying asset's useful life. While the entity revalues its owned property, plant and equipment, it has chosen not to do so for the right-of-use assets held by the entity.*

*Payments associated with short-term leases of equipment and all leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less without a purchase option. Low-value assets comprise IT equipment and small items of office furniture.”*

When preparing its financial statements for 20X2, Entity D has assessed that, in terms of amounts, its leasing activities when acting as the lessee are immaterial.

Should Entity D disclose accounting policy information for its leasing activities, acting as a lessee, in its financial statements for the year ended 31 December 20X2?



## Illustrative examples (continued)

### 2. Disclosures of accounting policies about leasing activities by a lessee (continued)

#### Analysis

Lease accounting, in general, requires significant judgements and assumptions to be made; for example, when identifying a lease, identifying any non-lease components, calculating the discount rate, deciding on the accounting for any variable lease payments and assessing the probability for execution of any purchase options or extension options.

However, Entity D considers that:

- the financial statements figures in respect of their leasing activities, acting as the lessee, are immaterial;
- Entity D did not change its accounting policies during 20X2;
- accounting policies for leases are described under MFRS, and not developed by Entity D based on the principles set out in MFRS 108 in the absence of a specific MFRS that deals with a similar issue; and
- leasing of the cars for Entity D is relatively uncomplicated from an accounting perspective.

Based on the fact pattern presented, Entity D is likely to conclude that accounting policy information for the leasing activities, when acting as a lessee, is not material for a user's understanding of its financial statements for the year 20X2.

The entity could risk obscuring material information in its financial statements if accounting policy information on leasing activities as a lessee is disclosed [MFRS 101.117D].

Consequently, the accounting policy information related to the entity's activities as a lessee would not be required to be disclosed [MFRS 101.117A]. Entity D would need to separately assess whether it should include accounting policy disclosure for its activities as a lessor.

In addition, Entity D should consider which disclosures should be made in accordance with MFRS 16 (in its activities as lessee) and MFRS 124 'Related party Disclosures' (regarding the transactions with the CEO and CFO as related parties) [MFRS 101.117E].



## Illustrative examples (continued)

### 3. Disclosures of accounting policies for fixed-fee services contracts

#### Background information

Entity F is a property management company providing property management services to customers through fixed-fee service contracts. The contracts are for periods of 3–5 years and cover property management and repair work. Entity F is responsible for keeping the properties at a pre-defined standard, and all necessary repair and maintenance work is covered by Entity F as part of the fixed-fee contract.

The customers themselves are responsible for excessive repair work which does not arise from normal wear and tear, e.g. fire, or natural disasters such as flood or storm.

The contract fee agreed at inception is based on standard price factors such as the property's age, size and area of location. Entity F does not conduct a specific assessment of the property's condition.

Entity F concludes that its contracts with external customers meet the definition of an insurance contract in MFRS 17 'Insurance Contracts'. As permitted by MFRS 17, Entity F has an accounting policy choice to either account for these fixed-fee service contracts applying MFRS 15 instead of MFRS 17 if the prescribed conditions are met.

Entity F has chosen, as an accounting policy choice, to account for the fixed-fee service contracts in accordance with MFRS 17 and applied the policy retrospectively in the comparative period as well.

At year-end 20X2, management of Entity F concluded that, in terms of value, its fixed-fee service contracts could be determined material for its financial statements.

Should Entity F disclose accounting policy information for its fixed-fee service contracts in its financial statements for the year ended 31 December 20X2?



## Illustrative examples (continued)

### 3. Disclosures of accounting policies for fixed-fee services contracts (continued)

#### Analysis

Entity F considers that:

- the accounting policies were unchanged during the year; and
- the accounting policies are described in MFRS, and not developed by Entity F based on the principles set out in MFRS 108 in the absence of a specific MFRS that deals with a similar issue.

However, Entity F further assesses that:

- the fixed-fee service contracts could be determined material;
- the accounting policies were chosen from a set of alternatives (MFRS 15 or MFRS 17) [MFRS 101.117B(b)];
- the measurement requirements in MFRS 17 are complex, requiring significant judgements and assumptions to be made [MFRS 101.117B(d)-(e)]; and
- the liability for remaining coverage is associated with a high degree of estimation uncertainty [MFRS 101.117B(d)].

Considering all facts and circumstances presented, based on the fact that the accounting policy relates to material transactions, there is an accounting policy choice available and the level of complexity and judgement required, Entity F is likely to conclude that accounting policy information about its fixed-fee service contracts is material for an understanding of its financial statements for the year ending 31 December 20X2.

Entity F would disclose accounting policy information about its accounting for fixed-fee service contracts. Further, the disclosure requirements in MFRS 17 will apply.

Do you need further information on this topic?

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