Sri Lanka Financial Reporting Standards (SLFRS/LKAS)

Transparency and Governance through enhanced financial reporting
What is in store?

2009 Version of IFRS/IAS
- 28 Standards revised
- 12 New Standards
- 26 IFRICS and SIC
- Global Industry practices
- IFRS Application Guidance

2004 Version of IFRS/IAS
- UITF Rulings
- Local practices
- SLAS Application Guidance

Old SLAS

SLFRS

Part 1
IFRIC/ SIC and BC
Part 2

Sri Lanka Accounting Standards - 2011
Applicable for financial periods beginning on or after 1 January 2011

Sri Lanka Accounting Standards - 2006

Quality In Everything We Do
The adoption of IFRS affects more than a company’s accounting policies, processes, and people. Ultimately, most aspects of a company’s business and operations are affected potentially.
Why is it Complex?

**Principle based standards**
- Use of Judgment – In the application of the standards, Bad debt provision, Operating Lease Vs Finance Lease
- Rights and obligations arising from business arrangement
- Substance over legal form

**What can be done?**
- All contracts in to be reviewed to identify measurement and disclosure issues.
- In order to avoid judgment, assistance through system configuration

**Future**
- Possible renegotiation of T&C
- All contracts to be centralized in the future
What is ahead?

What is going to be Financial Analyst role?
IFRS Financial Statements Vs Analyst Role

IFRS Financial Statements

- More insight and detail on Financial Information
- IFRS Financial Statements provide both quantitative and qualitative data.
- Details disclosures on risk management
- Increased transparency on information
- Financials are based the eyes of the Management.

Analyst Role

- Financial Analyst role will become easy due to availability of more information both qualitative and quantitative data
- Save the time taken dig and search for other information
- Ensure that reliable information is used - As those are audited
- However Analyst need to watch out - As IFRS is towards more principal based approaches and may not be comparable with entities in the same industry may not be the same
What Financial Analyst need to watch out?

► Revenue Recognition- Revenue recognized at fair value, gross vs net revenue
► Depreciation rate change, concept of component accounting, residual value of PPE, revaluation
► Classification recognition of Operating leases Vs Finance leases.
► Fair accounting approach- Biological Asset are fair valued.
► Financial Instruments- Amortized cost model vs fair value model
► Change in bad debt provisioning Polices- Impairment model based on objective evidence
► Assets impairment
► Business combination- Application of acquisition method, apply full goodwill method.
Key Issues for companies in 2012

<table>
<thead>
<tr>
<th>Key Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
</tr>
<tr>
<td>Arrangements containing Leases</td>
</tr>
<tr>
<td>Financial Instruments</td>
</tr>
<tr>
<td>Property Plant &amp; Equipment</td>
</tr>
<tr>
<td>Consolidation</td>
</tr>
<tr>
<td>Impairment</td>
</tr>
<tr>
<td>Share Based Payments</td>
</tr>
<tr>
<td>Presentation and Disclosures</td>
</tr>
<tr>
<td>Taxes</td>
</tr>
<tr>
<td>Employee Benefits</td>
</tr>
<tr>
<td>Earning per share</td>
</tr>
<tr>
<td>Intangible assets</td>
</tr>
</tbody>
</table>
Revenue: Multiple element contracts

- Revenue recognition issue arising from multi-element contracts, extended warranties, discounts, etc. Ex: a sale of goods with installation

- Contract needs to be split into its component parts, based on fair value of each part.

Questions?

- What will be the impact to revenue targets?
- How will you explain declines in revenue to your stakeholders?
- How will you manage your profit declines?
- Effect on share prices!!!

Issues

- How will you measure revenue?
- What is the FV of revenue to be split?
- How will you recognize the deferred revenue?
Revenue: Customer Loyalty Programmes

Issues

Revenue relating to redemption of points should be deferred.

Valuation of deferred revenue may be complex

Measurement should reflect the fair value of loyalty points.

Questions?

What will be the impact to revenue targets?

How will you explain declines in revenue to your stakeholders?

How will you manage your profit declines?

Effect on share prices!!!

Don’t Forget to Use Your Star Points Next Time
Revenue: General issues

Issues

Gross vs net; determining whether the entity is the principle or the agent

Estimating of revenue recognition over long term service contracts

Measurement of Revenue at fair value

Do you have

• Sales with delayed delivery?
• Sales subject to conditions?
• Sale and repurchase agreements?
• Sales through distribution channels
• Barter transactions?
What does it mean for PPE?

<table>
<thead>
<tr>
<th>Component approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identification of significant components</td>
</tr>
<tr>
<td>Depreciated over their own useful lives, rather than the life of the asset</td>
</tr>
<tr>
<td>Residual values of fixed assets must be assessed</td>
</tr>
<tr>
<td>Depreciation method &amp; residual value to be reviewed annually</td>
</tr>
</tbody>
</table>
Decommissioning costs

- An obligation to decommission an asset at the end of its life will entail estimating related costs and accounting for it on day 1.

**Key Points**

<table>
<thead>
<tr>
<th>Provision for the costs of dismantling and removing the item, and restoring the site</th>
</tr>
</thead>
<tbody>
<tr>
<td>The provision to be estimated and discounted to its present value at initial recognition</td>
</tr>
<tr>
<td>The unwinding of discount is recognized as an interest expense</td>
</tr>
<tr>
<td>Residual values of fixed assets must be assessed</td>
</tr>
<tr>
<td>Initial estimate of the provision is capitalized as a component of the asset</td>
</tr>
</tbody>
</table>
Share based payments

A share-based payment transaction is one in which the entity
receives goods or services from the supplier of those goods or services (including an employee) in a share-based payment arrangement, or
incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group entity receives those goods or services.

Issues
Share based payments are recognized when goods and services are received
Increase in expense and liability or equity
Measurement at FV of goods and services received or equity instruments

Are you ready for the
New expense, liability or equity items?
Valuation of goods and services?
NOT only employee share options!!!
This entailed a major change from established accounting practices.

The application of fair value to biological assets
Leases – IFRIC 4

- An arrangement that do not take the legal form of a lease but which convey the rights to use an asset in return for a payment or series of payments, contains a lease.

**Key Points**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fulfillment of the arrangement depends upon a specific asset</td>
<td>Are you ready to explain the upheaval in your FS?</td>
</tr>
<tr>
<td>A right to control the use of the underlying asset</td>
<td>Do you have the expertise to determine the outcome of the arrangement?</td>
</tr>
<tr>
<td>Price is not contractually fixed per unit of output nor is it equal to the market price</td>
<td>Do you have the expertise to value the lease?</td>
</tr>
<tr>
<td>The output and/or physical access to the asset is controlled</td>
<td>What will happened when the assets that have been pledged will no longer be shown on your FS?</td>
</tr>
</tbody>
</table>
Leases – IFRIC 4

1. Is the fulfillment of the arrangement dependent on the use of a specific asset or assets?
   - Yes
   - No

2a. Is it remote that one or more parties other than the purchaser will take more than an insignificant amount of the output/other utility that will be produced or generated by the asset?
   - Yes
   - No

2b. Is the price that the purchaser will pay for the output contractually fixed per unit of output as of the time of delivery of the output?
   - Yes
   - No

2c. Is the price that the purchaser will pay for the output equal to the time of delivery of the output?
   - Yes
   - No

3. Does the purchaser obtain or control more than an insignificant amount of the output or other utility of the asset?
   - Yes
   - No

4a. Does the purchaser have the ability or right to operate the asset or direct others to operate the asset in a manner it determines?
   - Yes
   - No

4b. Does the purchaser have the ability or right to control physical access to the underlying asset?
   - Yes
   - No

The arrangement does not contain a lease

The arrangement contains a lease
Impairment of Assets

**When?**

- **Annual Assessment**
  - Intangible assets
    - With indefinite useful life
    - Not yet available for use
  - Goodwill through business combination
- Other assets - when impairment conditions exist

**Issues**

- Identification of CGU
- Identification of Impairment indicators
- Measurement
- Disclosures
Impairment of Assets

Practical Issues

- Identification of Impairment Indicators - External/ Internal
  - Market Capitalization as a special impairment indicator
- Testing for impairment at the end of each interim reporting period.
- Allocating or reallocating goodwill to cash generating units
- Valuation Issues
- Goodwill Impairment Disclosures.
What is ahead?

Are you ready for Financial Instruments?
Financial Instruments
Who and what is affected?

<table>
<thead>
<tr>
<th>What is covered?</th>
<th>Examples of Financial Instruments:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definition</td>
<td>► Cash</td>
</tr>
<tr>
<td>Recognition and Derecognition</td>
<td>► Receivables – Trade receivables, loans, advances, etc.</td>
</tr>
<tr>
<td>Measurement</td>
<td>► Payables – Trade payables, Loans, debentures, etc.</td>
</tr>
<tr>
<td>Reclassifications</td>
<td>► Investments in Quoted shares – Current &amp; Non current investment</td>
</tr>
<tr>
<td>Impairment</td>
<td>► Corporate Guarantees</td>
</tr>
<tr>
<td>Hedging</td>
<td>► Intercompany Loans</td>
</tr>
<tr>
<td>Presentation and Disclosures</td>
<td></td>
</tr>
</tbody>
</table>
What is a Financial Instrument?

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.
Financial Liability

Any contractual obligation:
► to deliver cash or another financial asset to another entity; or
► to exchange financial instruments with another entity under conditions that are potentially unfavorable.

Equity Instruments

► Any contract that evidences a residual interest in the assets of an enterprise after deducting all of its liabilities.

Financial Assets

Any asset that is:
► Cash
► an equity instrument of another entity
► a contractual right:
  ► to receive cash or another financial asset from another entity
  ► to exchange financial instruments with another entity under conditions that are potentially favorable
Categories of Financial Assets

<table>
<thead>
<tr>
<th>Asset</th>
<th>Classification</th>
<th>Initial Measurement</th>
<th>A/C for Transaction Costs</th>
<th>Subsequent Measurement</th>
<th>Treatment of FV</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FVPL</td>
<td>FV</td>
<td>Expensed</td>
<td>FV</td>
<td>Adjust to P&amp;L</td>
</tr>
<tr>
<td></td>
<td>HTM</td>
<td>FV</td>
<td>Capitalised</td>
<td>Amortised Cost</td>
<td>Adjust to Equity</td>
</tr>
<tr>
<td></td>
<td>L&amp;R</td>
<td>FV</td>
<td>Capitalised</td>
<td>Amortised Cost</td>
<td></td>
</tr>
<tr>
<td></td>
<td>AFS</td>
<td>FV</td>
<td>Capitalised</td>
<td>FV</td>
<td></td>
</tr>
</tbody>
</table>
## Impairment

<table>
<thead>
<tr>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bad debt provision policy</td>
<td>Evaluation of Impairment conditions</td>
</tr>
<tr>
<td></td>
<td>Identification of Significant Account balances</td>
</tr>
<tr>
<td></td>
<td>Individual assessments for Significant balances</td>
</tr>
<tr>
<td></td>
<td>Collective assessment for balances below threshold</td>
</tr>
</tbody>
</table>

### Are you ready?

- Information is provided by Operations!
- Availability of Information!
Impairment Process

Is the asset individually significant?*

YES

Is there objective evidence of incurred loss?

YES

Is the loan’s carrying value greater than the estimated future cash flows discounted at the EIR?

YES

Quantify and raise specific provision

NO

NO

END

NO

NO

Group assets according to risk characteristics?

YES

Is there collective objective evidence of incurred loss?

YES

Quantify & raise collective impairment provision

* Regardless of amount, if there is objective evidence of impairment, specific impairment testing will apply
De-recognition

- Setting the frame
  - Who is the entity?
  - What is the transferred asset?

- Transfer or pass-through of cash flows
  - Have the contractual rights expired?
  - Is there a transfer of rights to receive payments?
  - Is there a qualifying pass-through of cash flows?

- Risks and rewards
  - Has the entity transferred substantially all risks and rewards?
  - Has the entity retained substantially all risks and rewards?

- Control and continuing involvement
  - Has entity retained control of assets?
  - What is the continuing involvement?
New requirements for Business Combinations
Business combinations

Business (Inputs and Processes) + Control (IAS 27) = Business Combination

Acquisition Method

- Identify the acquirer
- Determine the acquisition date
- Assets acquired, the liabilities assumed and any non-controlling interest in the acquiree
- Goodwill or a gain from a bargain purchase

If not, deemed as an asset acquisition

Account as an asset acquisition using relative FV
Business combinations

FV of consideration + Non Controlling Interest + FV of prior interest - 100% FV of net assets acquired = Goodwill/gain from a bargain purchase

Option 1 – FV of NCI
Option 2 - % of FV of NA

Impairment

Do you have the

Expertise to identify Business Combinations?

Expertise to perform the valuations?

Are you ready for the Accounting Implications?
How will the required disclosures impact you?
Risk reporting
Disclosures – LKAS 1 Presentation of Financial Statements

Disclose information about:
- Assumptions it makes about the future,
- Other major sources of estimation uncertainty at the end of the reporting period

Examples of the types of disclosures:
- (a) the nature of the assumption or other estimation uncertainty;
- (b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;
- (c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year
- (d) an explanation of changes made to past assumptions, if the uncertainty remains unresolved.
Disclosures – SLFRS 8 - Operating Segments

► Users want to know the risks- Enable users evaluate the nature and financial effect of its business activities an entity engages in and the environment in which it operates

► Operating segment disclosures are based on components which management monitors for making decisions

► Identified based on internal reports reviewed by the CODM in:
  ► Allocating resources
  ► Assessing segment performance

► Application in practice require significant judgment
Disclosures – SLFRS 7 Financial Instruments

- All risks arising from financial instruments to be disclosed.

<table>
<thead>
<tr>
<th>Are you ready to disclose?</th>
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<tbody>
<tr>
<td>Risk management policies – Management’s objectives, policies and processes for managing risks</td>
</tr>
<tr>
<td>Your credit risk, liquidity risk and market risk</td>
</tr>
<tr>
<td>- Bad debts (Credit Risk)</td>
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<td></td>
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<tr>
<td>- Liquidity Risk</td>
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<td></td>
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<tr>
<td>- Market Risk</td>
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<tr>
<td></td>
</tr>
<tr>
<td>- Sensitivity Disclosures</td>
</tr>
<tr>
<td>- Level of Fair Value (FV Hierarchy)</td>
</tr>
</tbody>
</table>

These will be subject to audit!
Proper process/systems to gather data
Disclosures will be compared by analysts/stakeholders
Disclosures – LKAS 24

Disclosure of transactions, and outstanding balances with related parties that have the possibility of affecting the financial position and financial performance

<table>
<thead>
<tr>
<th>Identification of related parties and the entity</th>
<th>Identification related parties</th>
<th>Entities need to</th>
<th>Disclosures</th>
</tr>
</thead>
<tbody>
<tr>
<td>► Subsidiaries, joint ventures and associates</td>
<td>► Subsidiaries, joint ventures and associates</td>
<td>► Institute processes to provide these disclosures</td>
<td>KMP compensation in total and for each category</td>
</tr>
<tr>
<td>► Significant owners</td>
<td>► Significant owners</td>
<td></td>
<td>► Parent (s)</td>
</tr>
<tr>
<td>► KMP’s and close family members</td>
<td>► KMP’s and close family members</td>
<td>► Review system capabilities to track information</td>
<td>► Significant investors</td>
</tr>
<tr>
<td>► Transactions entered into with RP</td>
<td></td>
<td></td>
<td>► Subsidiaries</td>
</tr>
<tr>
<td>► Companies needs to institute processes to provide these disclosures</td>
<td></td>
<td></td>
<td>► JV/Associates</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>► KMP</td>
</tr>
<tr>
<td></td>
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<td>► Other RP</td>
</tr>
</tbody>
</table>
Related Party Definition: Can you capture all?

- **Parent**: B Ltd
- **Control**: C Ltd
- **Significant Influence**: K Ltd
- **Joint Control**: L Ltd
- **Subsidiary**: J Ltd
- **Fellow Subsidiary**: I Ltd
- **Associate**: G Ltd
- **JV**: M Ltd

**Reporting Entity (A Ltd)**

- **Control**: D Ltd
- **Significant Influence**: C Ltd
- **Joint Control**: H Ltd

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**KEY**

- **Control (C)**
- **Significant Influence (SI)**
- **Joint Control (JC)**
SLFRS conversion dimensions – more than a change in accounting policy

What’s Involved?

• The scope and complexity involved in the conversion to SLFRS should not be underestimated.

• The new standards involve changes in presentation, new valuation rules, and additional disclosure requirements.

• A successful conversion must plan and manage change across business processes, technologies, and the organization impacting both the group and business unit levels.

• ERP configurations will likely be impacted across multiple modules.

• Financial system architectures may require substantive modifications.

Conversion scope/content

► SLFRS conversion will impact all levels of accounting in a business.

► SLFRS conversions will impact several areas of the business outside of the accounting function.

► A top level conversion to SLFRS may not be sufficient.
Looking Ahead

The IASB has already issued the following Standards and would be effective for Financial periods commencing on 1st Jan 2013:

- IFRS 10 - Consolidated Financial Statements
- IFRS 11 - Joint Arrangements
- IFRS 12 - Disclosure of Interest in other entities
- IFRS 13 – Fair Value Measurement

IFRS 9 has been delayed till 2015
Sweeping changes to accounting standards

[December 2011]
Agenda

Sweeping change is coming
Projected timing
How we see it
Impact on your business
What leading companies do to prepare
Next steps
Sweeping change is coming

Globalization has driven increased interconnection of markets and investors.

The financial crisis has accelerated political pressure for consistent accounting guidance and a robust global regulatory framework.

Significant changes to fundamental accounting and reporting models are being proposed under both IFRS and US GAAP.

Navigating the uncertainty and complexity will be challenging and will put pressure on the finance function.
# Projected timing

<table>
<thead>
<tr>
<th>Proposals</th>
<th>Final standards</th>
<th>Deferred projects</th>
<th>Preparing for implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Input was gathered through broad-based stakeholder outreach programs, including webcasts, workshops, roundtables, meetings and comment letters.</td>
<td>The priority projects (financial instruments, revenue recognition, leases and insurance) are expected to be finalized in 2011 and 2012.</td>
<td>Additional projects, such as financial statement presentation and financial instruments with the characteristics of equity, have been deferred.</td>
<td>The timing and approach for implementation remains undecided. Input on effective dates is being considered. Early adoption will likely be permitted for IFRS adopters.</td>
</tr>
</tbody>
</table>

Retroactive application will likely require advance preparation
How we see it

The major projects will likely affect financial reporting for many years to come.

We support the Boards’ commitment to conducting outreach during the re-deliberations period.

We also support the Boards’ decision to extend their timetables and re-expose certain projects.

We encourage stakeholders to use this opportunity to participate in the standard-setting process.

Although delayed, the changes are coming and we believe that companies need to start preparing now.
## Impact on your business

Accounting change will affect the five common strategic priorities of most businesses

<table>
<thead>
<tr>
<th>Top line growth</th>
<th>Timing of revenue recognition may change. Standard customer contracts may need to be reconsidered.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focus on managing costs</td>
<td>Systems and business processes may need to be revised or newly implemented. Early assessment can lead to efficiencies, and help avoid costly re-design and re-work.</td>
</tr>
<tr>
<td>Robustness of forecasting and strategic planning</td>
<td>Changes to financial measures may affect budgets, debt covenants, incentives, and performance targets. Early identification of these areas will help facilitate timely action.</td>
</tr>
<tr>
<td>Transparency in reporting and investor relations</td>
<td>Financial results and performance metrics may change. Proactive communication to investors, analysts, and other key stakeholders will help prevent market misperceptions and present a clear picture of the company’s financial position.</td>
</tr>
<tr>
<td>Strengthening internal control and risk management</td>
<td>Significant execution risk exists when implementing organization-wide changes in an evolving regulatory environment. Assessing exposures and assigning responsibilities early on will help mitigate that risk.</td>
</tr>
</tbody>
</table>
Impact on your business

<table>
<thead>
<tr>
<th>Changes</th>
<th>Potential reporting and business implications</th>
<th>Key considerations</th>
</tr>
</thead>
</table>
| Revenue recognition | • Revenue recognition may change based on the structure of certain performance obligations within contracts.  
• Timing of the satisfaction of performance obligations may change with the new concepts of the transfer of control. | • What contractual relationships (e.g., customer contracts, commission arrangements, bonus plans) are affected and need to be reassessed or terms renegotiated? |
| Leases | • Key profit/loss, balance sheet and cash flow metrics would change in industries that rely heavily on leased assets such as retail, airlines and real estate.  
• Borrowing capacity may be affected.  
• Changes may affect decisions to lease versus buy significant assets. | • Which leases currently being negotiated should be evaluated in light of the proposed changes?  
• How will existing lease agreements be inventoried and the required data gathered?  
• What IT solution will be used to store incremental lease data and perform present value calculations?  
• How will recognizing leases on balance sheet affect the nature and extent of leasing activities? |
| Financial instruments | • Whether and when amounts are recognized in net profit will change due to changes in classification and measurement of financial instruments.  
• Impairments may be recognized earlier.  
• Qualifying for hedge accounting would be easier.  
• Accounting results under IFRS may better align with risk management objectives.  
• Balance sheet presentation may change. | • What changes to processes, controls and systems will be required to assess classification, measurement and rights of offset of financial assets and liabilities?  
• What systems changes will be needed to accommodate the new approach to recognizing and recording impairment losses, including new estimates of credit losses and impairment calculations?  
• What resources will be required to identify new hedging relationships and perform hedge effectiveness calculations? |

The Boards will re-expose the proposals.

The proposal would eliminate the distinction between operating and capital/finance leases and would result in nearly all leases being reflected on the balance sheet.

The Boards’ overall objective is to simplify, improve and converge the accounting for financial instruments. The project is being conducted in phases. Although this is a joint project, the Boards have deliberated many issues separately.
What leading companies do to prepare

- Develop a communications plan and draft communications to stakeholders on effect of adoption.
- Review and consider changes to accounting manuals and policies as needed.
- Analyze tax positions arising from adopting the new proposal, reducing tax exposure and determining the tax effects.
- Assess business processes for data collection, internal controls and IT systems.
- Review exposure drafts and related material to gain an understanding of proposed changes.
- Understand how others within your industry are approaching the proposals, the problems they have encountered and solutions being developed.
- Assess the impact on financial statements.
- Evaluate the income statement impact of adoption and assess the impact on key financial ratios and performance measures.
- Consider accounting policies.
- Communicate and promote stakeholder confidence.
- Benchmark against industry peers.
- Assess impact on strategic business decisions.
- Assess impact on strategic business decisions and planned transactions.
- Assess impact on financial statements.
- Review and identify process and systems requirements.
- Gain an understanding.
Impact on your business

<table>
<thead>
<tr>
<th>Changes</th>
<th>Potential reporting and business implications</th>
<th>Key considerations</th>
</tr>
</thead>
</table>
| **Consolidations — IASB only (Standard issued May 2011)** | • Key profit/loss and balance sheet metrics may change if a different conclusion regarding control is reached (i.e., with more or fewer entities being consolidated than under current IFRS).  
• Continuous re-assessment of control would be required as facts and circumstances change. | • Should the structure of transactions being negotiated be reconsidered in light of the changes?  
• What information regarding investees and rights, including those held by other shareholders, is required to assess control and apply the standard? How will the entity obtain this information?  
• What new processes or controls will be required to assess control of an investee and ensure the accuracy of accounting for newly controlled investees? |
| **Insurance** | • Potential for significant earnings volatility exists.  
• Volume measures (e.g., premiums) may be overshadowed by summarized earnings amounts.  
• Profit emergence may be affected by the use of current estimates and changes in the types of acquisition costs that can be deferred. | • What changes will be required to controls, process and data management to capture information and perform the modeling necessary to calculate the liability?  
• What approach is needed to analyze and explain performance with the focus of the income statement shifting from volume measures to key profitability drivers?  
• What actions will companies need to take to educate financial statement users about current results and future profit emergence? |

The Boards proposed measurement models for insurance liabilities that incorporate current estimates of discounted cash flows remeasured at each reporting date.