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- For more information on assurance services:

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National Consumer Products Industry Leader
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Recently Issued accounting pronouncements and their effect on entities in the Consumer Products industry
Your Presenters

• Carol Lapidus
  • Partner – New York, NY
  • National Leader – Consumer Products

• Peter Cadigan
  • Senior Manager – New York, NY
  • NY Consumer Products industry team member

• Myles Silvers
  • Manager – New York, NY
  • NY Consumer Products industry team member
## Overview

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<td>Introduction</td>
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<td>Revenue recognition</td>
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<td>Other recently issues accounting pronouncements</td>
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REVENUE RECOGNITION
What’s changing?

• **Overall model** is based on transferring control instead of transferring risks and rewards of ownership

• **Collectibility** assessment is more complex and the revenue recognition model used when collectibility is not probable could result in delayed revenue recognition (even with respect to nonrefundable cash received)

• **Multiple-element arrangements** are subject to the following new requirements:
  • For separation purposes, must apply incremental criterion focused on whether a promised good or service is separately identifiable from other promised goods or services in the contract
  • For allocation purposes, must allocate discounts and (or) variable consideration to less than all performance obligations in certain circumstances

• **Warranties** are evaluated to determine if they represent a performance obligation to which revenue is allocated

• **Variable consideration** may be recognized earlier in certain circumstances
What’s changing?

- **Significant financing component** guidance is applied to both deferred and advance payments, which may result in the recognition of interest income (deferred payment) or interest expense (advanced payment).

- **Recognition of revenue over time or at a point in time** (i.e., whether control of a performance obligation’s promised goods or services transfers over time or at a point in time) depends on whether one or more of three specific criteria are met.

- **Licenses** are evaluated to determine whether they include a right to use (point in time) or a right to access (over time) intellectual property.

- **Bill-and-hold transaction** criteria are less onerous.

- **Uninstalled materials** guidance may, in certain circumstances, result in recognizing revenue to the extent of their cost upon transfer of control.
What’s changing?

- **Contract modifications** are accounted for under a comprehensive model that provides for different outcomes depending on the facts and circumstances.
- **Balance sheet presentation** requires separate recognition of contract liabilities, accounts receivable and contract assets.
- **Disclosure requirements** are significant and likely involve tracking (and disclosing) a variety of information not historically tracked or disclosed.
- **Costs related to customer contracts** (e.g., costs to obtain or fulfill a customer contract) must be capitalized in certain circumstances.
- **Gains and losses from the derecognition of nonfinancial assets** that are not an output of the entity’s ordinary activities (e.g., real estate sales) are recognized, in large part, based on key aspects of ASC 606.
Scope

• All revenue-generating contracts with customers are within the scope of ASC 606, except for:
  • Leases
  • Contracts within the scope of ASC 944 (insurance)
  • Various contractual rights or obligations related to financial instruments
  • Guarantees other than warranties
  • Certain nonmonetary exchanges

• No industries are scoped out of ASC 606

• Key aspects of ASC 606 are used to account for the sale of nonfinancial assets that are not an output of the entity’s ordinary activities
  • For example, a bakery’s sale of used delivery trucks or a manufacturer’s sale of a manufacturing facility
Core principle

Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.
Key steps

1. Identify the contract with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognize revenue when (or as) each performance obligation is satisfied
5. Recognize revenue

KEY QUESTION:
Is a performance obligation satisfied (and control of the underlying good or service transferred) over time or at a point in time?
Warranties

Does the customer have the option to purchase the warranty separately?

Yes
- The warranty is a performance obligation

No
- Does the warranty (or part of the warranty) provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications?

Yes
- Depending on the facts and circumstances, the service-type warranty or the warranty as a whole is a performance obligation

No
- The warranty is not a performance obligation
Right of return or refund

• Right of return or refund is treated as variable consideration
  • Must estimate the amount of returns or refunds, likely using the expected value method
  • Does not include product exchanges when they are:
    • For the same type, quality, condition and price
    • Due to defects

• Estimated amount of returns or refunds:
  • Reduces transaction price
  • Recorded as a refund liability
Right of return or refund

• For product sales, recognize:
  • An asset for the right to returned inventory
    • Former carrying amount of the product less the expected costs to recover those products (includes expected decreases in the value of the returned product)
  • A corresponding adjustment to cost of sales for estimated returns
Significant financing component

• With limited exceptions, significant implicit or explicit financing components that benefit either the entity or the customer are reflected in the transaction price
  • Can occur with both advance and deferred payment terms
  • Whether a significant financing component exists depends on the facts and circumstances
    • What is the difference between: (a) the amount the customer would have had to pay upon transfer of the goods (i.e., cash selling price) and (b) the amount the customer pays under the contract?
    • How much time will pass between the transfer of the goods and services and payment for those goods or services and what are the prevailing interest rates in the relevant market?
Significant financing component

• Limited exceptions to reflecting a significant financing component in the transaction price include:
  • The customer makes an advance payment, but the timing of transferring the goods or services is at the customer’s discretion
  • Payment of substantial variable consideration is contingent on an uncertainty that the entity does not control
  • Reasons other than the provision of financing justify the difference in cash selling prices and promised consideration

• **Practical expedient:** A significant financing component may be ignored in estimating the transaction price if the difference between the following is expected to be one year or less at contract inception: (a) the entity’s transfer of goods or services and (b) the customer’s payment for goods or services
Consideration payable to a customer

- Consideration paid by the entity to its customers or its customers’ customers is reflected as a reduction of the transaction.
- If variable, the same rules apply
- Two exceptions must be met to record as operating expense
  - Distinct from the initial sale to the customer
  - Fair value can be reasonably estimated
Bill-and-hold transactions

- What is a bill-and-hold transaction?
  - A customer contract in which the entity bills the customer for a product, but the entity retains physical possession of the product for a period of time before it is transferred to the customer.

- Key question is whether control of the goods has transferred to the customer in a bill-and-hold transaction even though the customer has not yet taken delivery.
  - If control has transferred prior to delivery, there are likely warehousing services that should be accounted for as a performance obligation.
Bill-and-hold transactions

• Apply the general indicators of control transfer
  • The entity has a present right to payment for the distinct good or service
  • One or more of the following have transferred/passed to the customer
    • Legal title to the distinct good or service
    • Physical possession of the distinct good or service
    • Significant risks and rewards of ownership
  • The customer has accepted the distinct good or service

• Apply the incremental criteria provided in ASC 606
  • The reason for the bill-and-hold arrangement must be substantive (e.g., initiated by the customer)
  • The products must be separately identified as the customer’s product
  • The products must be ready for physical transfer to the customer
  • The products must not be able to be used by the entity or be redirected to another customer
Licensees

• Is a performance obligation made up of a license of IP satisfied over time or at a point in time?

IP has significant standalone functionality → Nature of promise is right to use → Satisfied at a point in time

IP does not have significant standalone functionality ("Symbolic IP") → Nature of promise is right to access → Satisfied over time

Except in limited circumstances
Disclosures

- Objective is to help financial statement users understand the nature, amount, timing and uncertainty of the related revenue and cash flows
- Annual and interim disclosures required of public entities
  - Less on an interim basis, but mostly quantitative in nature
- More disclosures required of PBEs and certain nonprofit entities and employee benefit plans
  - However, disclosures for all others are still significant
## Effective date

<table>
<thead>
<tr>
<th>Effective date of ASC 606</th>
<th>Calendar year end entities</th>
<th>June 30 year end entities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public entities, quarter and year beginning...</td>
<td>January 1, 2018</td>
<td>July 1, 2018</td>
</tr>
<tr>
<td>Other entities, year ending...</td>
<td>December 31, 2019</td>
<td>June 30, 2020</td>
</tr>
<tr>
<td><strong>Early adoption of ASC 606</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Allowed for both public entities and other entities...</td>
<td>As early as January 1, 2017</td>
<td>As early as July 1, 2017</td>
</tr>
</tbody>
</table>
Transition methods

• Entities may choose to apply one of the following transition methods:
  • Full retrospective application of ASC 606 to all periods presented
    • One or more of four practical expedients may be elected
  • Modified retrospective application as of the date of initial application of ASC 606
    • Recognition of a cumulative effect adjustment as of the date of initial application (i.e., prior periods are not adjusted)
    • One practical expedient may be elected
    • Disclose the effects on each line item in the financial statements of applying the new guidance in the period of adoption
LEASES
What does ASU 2016-02 change?

• For lessees
  • Most significant change is to record a lease liability and right-of-use (ROU) asset for most leases
  • Provided on the next slide is an illustrative balance sheet for a lessee with operating leases that predominantly consist of a building lease with a remaining lease term of 15 years
    • After giving effect to ASU 2016-02, the lessee reflects ROU assets and lease liabilities for its operating leases
What does ASU 2016-02 change for Lessees?

<table>
<thead>
<tr>
<th>Assets</th>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and equivalents</td>
<td>$1,260</td>
<td>$1,260</td>
</tr>
<tr>
<td>Accounts receivable, net</td>
<td>4,590</td>
<td>4,590</td>
</tr>
<tr>
<td>Inventory</td>
<td>5,830</td>
<td>5,830</td>
</tr>
<tr>
<td>Other current assets</td>
<td>680</td>
<td>680</td>
</tr>
<tr>
<td>Total current assets</td>
<td>12,360</td>
<td>12,360</td>
</tr>
<tr>
<td>Noncurrent assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property and equipment</td>
<td>17,820</td>
<td>17,820</td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td>(6,780)</td>
<td>(6,780)</td>
</tr>
<tr>
<td>Property and equipment, net</td>
<td>11,040</td>
<td>11,040</td>
</tr>
<tr>
<td>Right-of-use assets</td>
<td></td>
<td>12,540</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>1,960</td>
<td>1,960</td>
</tr>
<tr>
<td>Goodwill</td>
<td>1,370</td>
<td>1,370</td>
</tr>
<tr>
<td>Total assets</td>
<td>$26,730</td>
<td>$39,270</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities and equity</th>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable and other</td>
<td>$5,250</td>
<td>$5,250</td>
</tr>
<tr>
<td>Lease liabilities</td>
<td></td>
<td>870</td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>5,250</td>
<td>6,120</td>
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<tr>
<td>Noncurrent liabilities</td>
<td></td>
<td></td>
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<tr>
<td>Long-term debt</td>
<td>7,560</td>
<td>7,560</td>
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<tr>
<td>Lease liabilities</td>
<td></td>
<td>11,670</td>
</tr>
<tr>
<td>Deferred taxes</td>
<td>1,190</td>
<td>1,190</td>
</tr>
<tr>
<td>Shareholders’ equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>6,210</td>
<td>6,210</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>6,420</td>
<td>6,420</td>
</tr>
<tr>
<td>Total shareholders’ equity</td>
<td>12,730</td>
<td>12,730</td>
</tr>
<tr>
<td>Total liabilities and equity</td>
<td>$26,730</td>
<td>$39,270</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current ratio</td>
<td>2.35</td>
<td>2.02</td>
</tr>
<tr>
<td>Percentage change</td>
<td>(14%)</td>
<td></td>
</tr>
<tr>
<td>Debt-to-equity ratio</td>
<td>1.10</td>
<td>2.08</td>
</tr>
<tr>
<td>Percentage change</td>
<td>89%</td>
<td></td>
</tr>
</tbody>
</table>
What does ASU 2016-02 change?

• For lessors
  • Relative to lessees, changes were limited
  • One of the more significant changes is the prospective elimination of the leveraged lease accounting model
  • More discussion to come

• Changes in the following areas will affect both lessees and lessors
  • Definition of a lease
  • Lease classification criteria
  • Definition of initial direct costs
  • Separation of lease and nonlease components
  • Related party leases
  • Accounting for sale-leaseback transactions
  • Presentation and disclosure requirements
Leases overview

Determine if contract contains a lease
Separate lease and nonlease components
Classify the lease
Apply the appropriate accounting model
Present and disclose leases in financial statements
Scope

• ASC 842 is applicable to all leases except:
  • Leases of intangible assets
  • Leases to explore for or use minerals, oil, natural gas and similar nonregenerative resources
  • Leases of biological assets
  • Leases of inventory
  • Leases of assets under construction
Classifying the lease

- Five lease classification criteria to evaluate
  - Four of the criteria are similar to the lease classification criteria in the legacy lease guidance
    - However, no bright lines are provided
    - Instead, FASB suggests in the implementation guidance what a reasonable approach might be to evaluating certain criteria
  - For lessees, if:
    - No criteria are met: Operating lease
    - One or more criteria are met: Finance lease
Polling Question #3

• Which of the following leases will need to be reclassified under ASU 2016-02?

  • 18 month photocopier lease
  • 3 year auto lease
  • 15 year office lease
  • All of the above
Lessees: Financial statement presentation

• Balance sheet
  • ROU assets and lease liabilities for finance leases and operating leases should be presented as separate line items on the balance sheet or disclosed separately in the notes
    • If not presented separately on the balance sheet, must disclose which balance sheet line items include those assets and liabilities
    • ROU assets and lease liabilities related to finance leases cannot be included in the same balance sheet line items that include the ROU assets and lease liabilities related to operating leases
  • Portion of the lease liabilities that are expected to be paid within 12 months or less (or, if longer, the lessee’s operating cycle) should be classified as current
Lessees: Financial statement presentation

• Income statement
  • Finance leases
    • Classify the portion of the lease costs related to the amortization of the ROU asset and the portion related to interest on the lease liability consistent with how similar expenses are classified on the income statement
      • For example, classify consistent with how depreciation and interest expense related to the financed purchase of property, plant or equipment are classified
  • Operating leases
    • Include lease costs in the lessee’s income from continuing operations unless it is part of a discontinued operation
Lessees: Financial statement presentation

- **Cash flow statement**
  - **Finance leases**
    - Classify the portion of the lease payment representing repayment of principal as a financing activity
    - Classify the portion of the lease payment representing interest as an operating cash flow (unless some of the interest is capitalized in accordance with other guidance in the ASC)
    - Classify variable lease payments not included in the lease liability as an operating activity
  - **Operating leases**
    - Classify as operating activities (unless some of the payment is capitalized in accordance with other guidance in the ASC)
Lessees: Disclosures

• Extensive qualitative and quantitative disclosures are required
• Examples of information that should be disclosed include:
  • Qualitative discussion of:
    • The nature of an entity’s leases
    • Variable payment arrangements
    • Termination/purchase/renewal options
  • Quantitative information related to:
    • Amortization and interest for finance leases
    • Operating lease costs
Lessees: Disclosures

- Examples of information that should be disclosed include:
  - Quantitative information related to:
    - Variable lease costs
    - Short-term lease costs
    - Maturity analysis of lease liabilities
  - Qualitative and (or) quantitative information related to significant judgments and assumptions used in applying ASC 842, such as those involved in:
    - Determining whether a contract contains a lease
    - Determining/Estimating the standalone prices used to separate lease and nonlease components
Effective date

• PBEs and certain not-for-profit entities and employee benefit plans
  • Annual and interim periods in fiscal years beginning after December 15, 2018
    • For a calendar year end PBE, effective on January 1, 2019

• All other entities
  • Fiscal years beginning after December 15, 2019 and interim periods in fiscal years thereafter
    • For a calendar year end private entity, effective in the year ending December 31, 2020

• Early adoption permitted for all entities
Transition

• Modified retrospective transition
  • Full retrospective adoption is prohibited
  • All comparative periods presented are restated
  • Mechanics of transition and degree of complexity depend on:
    • The classification of the lease under the legacy lease guidance and ASC 842
    • Whether any practical expedients are elected
OTHER RECENTLY ISSUED OR EFFECTIVE ASUs
ASU 2014-15 – Disclosure of uncertainties about an entity’s ability to continue as a going concern

F/S issued or available for issuance

1 year

Conditions or events

Mitigating plans
ASU 2014-15 – Disclosure of uncertainties about an entity’s ability to continue as a going concern

-Principal conditions or events
-Management’s evaluation
-Management’s plans

F/S issued or available for issuance

1 year

Conditions or events

Mitigating plans
ASU 2014-15 – Disclosure of uncertainties about an entity’s ability to continue as a going concern

Disclose
- Principal conditions or events
- Management’s evaluation
- Management’s plans

Footnote: There is substantial doubt about the entity’s ability to continue as a going concern...

F/S issued or available for issuance

1 year

Conditions or events

Mitigating plans
ASU 2014-15 – Disclosure of uncertainties about an entity’s ability to continue as a going concern

Effective date for calendar year-ends

- Permitted
- Required
ASU 2014-18 – Accounting for identifiable intangible assets in a business combination

• Provides an accounting alternative for private companies to recognize fewer intangible assets separately in a business combination

• Private companies would no longer be required to separately recognize Non-Competition Agreements (NCA) or Customer-Related Intangibles (CRI) that are not capable of being sold or licensed independently

• CRIs that may still be required to be separately recognized include:
  • Mortgage servicing rights
  • Commodity supply contracts
  • Core deposits
  • Customer information
• Pre-existing NCAs and CRIs recognized in prior business combinations would not be impacted

• Alternative also applies to:
  • Equity method of accounting
  • Fresh-start reporting in a reorganization

• If alternative is elected, ASU 2014-02 must also be elected at the same time
  • ASU 2014-02 provides private companies with a simplified approach to the subsequent accounting for goodwill
ASU 2014-18 – Accounting for identifiable intangible assets in a business combination

- If alternative is elected, effective date for calendar year-ends is as follows:

- **Permitted if financial statements have not yet been made available for issuance**
  - 2015 and prior

- **Required on occurrence of first business combination**
  - 2016 and subsequent
ASU 2015-03 – Simplifying the presentation of debt issuance costs

• Requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability (same as debt discounts)

• The recognition and measurement guidance for debt issuance costs are not affected

**Effective date for calendar year-ends**

- Permitted
- Required

2016
ASU 2015-15 – Debt issuance costs associated with line-of-credit arrangements

- ASU 2015-03 requires entities to present debt issuance costs as a direct deduction from the carrying amount of the related debt.
- How should debt issuance costs for line-of-credit arrangements be treated?
ASU 2015-15 – Debt issuance costs associated with line-of-credit arrangements

- ASU 2015-03 requires entities to present debt issuance costs as a direct deduction from the carrying amount of the related debt.
- How should debt issuance costs for line-of-credit arrangements be treated?

**EXISTING**

- No objection if an entity defers and presents these debt issuance costs as an asset and subsequently amortizes these costs over the line-of-credit arrangement’s term.
- ASU 2015-15 was issued to codify this SEC staff announcement in the FASB ASC.

**AMENDED**
## ASU 2015-11 – Simplifying the measurement of inventory

<table>
<thead>
<tr>
<th>Measurement of Inventory - Existing</th>
<th>Measurement of Inventory - Amended</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower of:</td>
<td>Lower of:</td>
</tr>
<tr>
<td>▪ Cost</td>
<td>▪ Cost</td>
</tr>
<tr>
<td>or</td>
<td>or</td>
</tr>
<tr>
<td>▪ Market</td>
<td>▪ Net realizable value</td>
</tr>
<tr>
<td>or</td>
<td>or</td>
</tr>
<tr>
<td>▪ Net realizable value (ceiling)</td>
<td>Estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation — FASB ASC Master Glossary</td>
</tr>
<tr>
<td>▪ Replacement cost</td>
<td></td>
</tr>
<tr>
<td>▪ Net realizable value less an approximately normal profit margin (floor)</td>
<td></td>
</tr>
</tbody>
</table>
ASU 2015-11 – Simplifying the measurement of inventory

Effective date for calendar year-ends

- 2015: Permitted
- 2016: Permitted
- 2017: Required
ASU 2015-17 – Balance sheet classification of deferred taxes

- Requires an entity to separate deferred tax liabilities and assets into current and noncurrent amounts in a classified balance sheet.
ASU 2015-17 – Balance sheet classification of deferred taxes

- Requires an entity to separate deferred tax liabilities and assets into current and noncurrent amounts in a classified balance sheet

EXISTING

- Deferred tax liabilities and assets should be classified as noncurrent in a classified balance sheet
- No offset of deferred tax liabilities and assets attributable to different tax-paying components of the entity or to different tax jurisdictions
ASU 2015-17 – Balance sheet classification of deferred taxes

Effective date for calendar year-ends

Public entities
- Permitted (2017)
- Required (2018)

Other entities
- Permitted (2017)
- Required (2018)
Effective date

• If an entity elects an accounting alternative after its effective date, it must assess whether the accounting alternative is preferable in accordance with ASC 250
**Effective date**

- If an entity elects an accounting alternative after its effective date, it must assess whether the accounting alternative is preferable in accordance with ASC 250.

**Existing**

- Allows private companies to forgo a preferability assessment on initial election of these alternatives.
QUESTIONS AND CLOSING REMARKS
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I would like to learn more about (check all that apply):

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- Reducing risk in my business
- Technology helping my business
- Managing my audit needs
- Capitalizing on business opportunities
- Outsourcing or co-sourcing resources for my business
- Tax planning and preparation issues for my business
- Managing my personal wealth
- Managing M&A transactions

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Before we conclude

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2016 tax changes affecting consumer products companies

- Tuesday, December 13, 2016
- 2 pm EST | 1 pm CST | Noon MST | 11 am PST
- 60 minutes
- Up to 1.0 CPE credit
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