

Heads Up

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The revised guidance will change how entities identify and disclose information about disposal transactions under U.S. GAAP.

A Major Deal

FASB Issues ASU to Amend Discontinued-Operations Reporting

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On April 10, 2014, the FASB issued [ASU 2014-08](#),¹ which amends the definition of a discontinued operation in ASC 205-20 and requires entities to provide additional disclosures about disposal transactions that do not meet the discontinued-operations criteria. The revised guidance will change how entities identify and disclose information about disposal transactions under U.S. GAAP.

The FASB issued the ASU to provide more decision-useful information to users and to elevate the threshold for a disposal transaction to qualify as a discontinued operation (since too many disposal transactions were qualifying as discontinued operations under existing guidance). Under the previous guidance in ASC 205-20-45-1, the results of operations of a component of an entity were classified as a discontinued operation if all of the following conditions were met:

- The component “has been disposed of or is classified as held for sale.”
- “The operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction.”
- “The entity will not have any significant continuing involvement in the operations of the component after the disposal transaction.”

The new guidance eliminates the second and third criteria above and instead requires discontinued-operations treatment for disposals of a component or group of components that represents a strategic shift that has or will have a major impact on an entity’s operations or financial results. The ASU also expands the scope of ASC 205-20 to disposals of equity method investments and acquired businesses held for sale.

Further, the ASU (1) expands disclosure requirements for transactions that meet the definition of a discontinued operation and (2) requires entities to disclose information about individually significant components that are disposed of or held for sale and do not qualify as discontinued operations.

The ASU also requires entities to reclassify assets and liabilities of a discontinued operation for all comparative periods presented in the statement of financial position. Before these amendments, ASC 205-20 neither required nor prohibited such presentation.

Regarding the statement of cash flows, an entity must disclose, in all periods presented, either (1) operating and investing cash flows or (2) depreciation and amortization, capital expenditures, and significant operating and investing noncash items related to the discontinued operation. This presentation requirement represents a significant change from previous guidance.

¹ FASB Accounting Standards Update No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*.

The new guidance is likely to have the greatest impact on entities that enter into routine disposal transactions, such as those in the real estate or retail industries.

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The ASU is effective prospectively for all disposals (except disposals classified as held for sale before the adoption date) or components initially classified as held for sale in periods beginning on or after December 15, 2014, with early adoption permitted.

This *Heads Up* summarizes the key provisions of ASU 2014-08.

Scope

Previously, investments in equity securities accounted for under the equity method were outside the scope of ASC 205-20. The ASU eliminates that scope exception. In addition, the ASU notes that “[a] business or nonprofit activity that, on acquisition, meets the criteria to be classified as held for sale is reported in discontinued operations.” Further, the ASU removed the discontinued-operations scope exceptions in ASC 360-10-15-5 but retained the exception for oil and gas properties accounted for under the full-cost method.

Recognition Criteria

Under the revised guidance, the unit of account for evaluating disposals (other than an acquired business or nonprofit activity) continues to be a component of an entity or a group of components of an entity; the ASU retains the existing definition of a component of an entity. Disposal classification categories are described below.

Discontinued Operation

ASU 2014-08 defines a discontinued operation as a component or group of components of an entity that (1) has been disposed of by sale or other than by sale in accordance with ASC 360-10-45-15, or is classified as held for sale, and (2) “represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results.” According to the ASU, a strategic shift that has (or will have) a major effect on an entity’s operations and results includes the disposal of any of the following:

- A major geographical area.
- A major line of business.
- A major equity method investment.
- Other major parts of an entity.

Editor’s Note: Given the ambiguous nature of the new guidance, an entity will need to use judgment in determining whether a strategic shift has occurred. Whether an entity disposes of a reportable segment, an operating segment, a subsidiary, or another component, determining the disposal’s importance to the entity and financial statement users will be critical to whether the disposal represents a strategic shift. For example, when an entity disposes of a reportable segment, before considering whether the disposal has a major effect on an entity’s operations or financial results, the entity will most likely conclude that the disposal represents a strategic shift — this is because of the level of discussion and disclosure on reportable segments in the financial statements and forepart of the Form 10-K/10-Q (e.g., business description, risk factors, MD&A). Because an entity will need to use significant judgment in making such a determination, the new guidance may result in diversity in practice.

The ASU does not define the terms “major,” “line of business,” or “geographical area.” It does, however, provide examples illustrating the evaluation of whether a disposal qualifies as a discontinued operation. These examples illustrate the quantitative thresholds of various metrics (e.g., assets, revenue, net income) — ranging from 15 percent to 20 percent as of the disposal date and 30 percent to 40 percent in historical periods — in various scenarios in which there was a strategic shift in an entity’s operations that has (or will have) a major effect on the entity’s financial results.

See [Appendix A](#) for more information about these illustrative examples.

Entities will need to use judgment in determining what constitutes “major.”

Editor’s Note: Entities will need to use judgment in determining what constitutes “major.” Some may interpret the illustrative guidance in ASC 205-20-55-83 through 55-101 as implying that breaching quantitative thresholds in the range of 15 percent to 20 percent indicates that a disposal is major. However, note that the FASB intentionally avoided creating a bright-line quantitative threshold because qualitative factors may also affect this assessment.

Entities may also find it challenging to define the terms “line of business” and “geographical area.” For example, some entities may define a geographical area as a county, state, country, or continent, while others may base this definition on how management determines its regions. Further, there may be differences in how entities define a major line of business: some may weight quantitative considerations more heavily, while others may stress qualitative factors.

Continuing Involvement

Although the FASB removed the notion of continuing involvement from the definition of a discontinued operation, the ASU requires entities to disclose the nature of any significant continuing involvement, including cash flows from or to the discontinued operation, as long as the discontinued operation is included in the financial statements presented. Some examples of continuing involvement include (1) supply chain and distribution agreements, (2) financial guarantees, (3) options to repurchase assets that were disposed of, and (4) equity method investments.

See [Appendix B](#) for more information about disclosure requirements when an entity retains significant continuing involvement.

Initial Criteria for Held-for-Sale Classification

ASU 2014-08 added to ASC 205-20 the held-for-sale criteria and exceptions to the requirement to complete the sale within one year, both of which are similar to the existing guidance in ASC 360.

Editor’s Note: An asset group that is to be distributed to its owners in a spinoff is classified as held and used until the distribution date. Accordingly, entities that announce a spinoff before adopting ASU 2014-08 and have a distribution date post-adoption, will apply the guidance in the ASU to the distribution.

Individually Significant Component

The ASU also requires entities to provide certain disclosures about disposals that do not meet the criteria for a discontinued operation but are considered individually significant components. These disclosure requirements are described in more detail in the [Disclosures](#) section and [Appendix C](#) of this *Heads Up*.

Editor’s Note: The ASU does not clearly define how an entity would establish whether a component, business, or not-for-profit activity is individually significant. For instance, it is unclear how established materiality concepts are interconnected with an entity’s determination of whether a disposal is major, individually significant, or not significant. As with their assessment of strategic shift and “major,” entities will need to use significant judgment in making this determination.

Presentation

Balance Sheet

The ASU requires entities to separately present assets and liabilities of a discontinued operation for all comparative periods on the face of the balance sheet. Before these amendments, ASC 205-20 neither required nor prohibited such presentation, which resulted in diversity in practice.

The ASU requires entities to reclassify assets and liabilities of a discontinued operation for all comparative periods presented in the balance sheet. Before these amendments, ASC 205-20 neither required nor prohibited such presentation.

Different presentation requirements apply to disposal groups that meet the held-for-sale criteria but do not meet the definition of a discontinued operation. In these instances, an entity is required to separately present assets and liabilities on the face of the balance sheet in the initial period in which the disposal group is classified as held for sale, and the entity does not reclassify previously reported amounts. In addition, the ASU states that for each period in which assets and liabilities are separately presented on the balance sheet, those amounts “shall not be offset and presented as a single amount.” Furthermore, entities are required to disclose the major classes of assets and liabilities either on the face of the balance sheet or in the notes to the financial statements.

Income Statement

An entity will present a gain or loss recognized in a disposal transaction that qualifies as a discontinued operation (or in a classification as held for sale) on either (1) the face of the income statement, with net income reported as part of discontinued operations, or (2) in the notes to the financial statements. In contrast, the gain or loss recognized on a disposal that does not qualify as a discontinued operation (i.e., a sale of a significant component or an immaterial disposal) should be included in income from continuing operations.

Further, ASC 205-20-45-3C (added by the ASU) states:

A gain or loss recognized on the disposal (or loss recognized on classification as held for sale) of a discontinued operation shall be calculated in accordance with the guidance in other Subtopics. For example, if a discontinued operation is within the scope of Topic 360 on property, plant, and equipment, an entity shall follow the guidance in paragraphs 360-10-35-37 through 35-45 and 360-10-40-5 for calculating the gain or loss recognized on the disposal (or loss on classification as held for sale) of the discontinued operation.

In addition, the ASU requires entities to present separately in the discontinued operations section of the income statement any adjustments to amounts previously reported in discontinued operations in a prior period. The ASU indicates that examples of circumstances in which adjustments may be presented include:

- “The resolution of contingencies that arise pursuant to the terms of the disposal transaction, such as the resolution of purchase price adjustments and indemnification issues with the purchaser.”
- “The resolution of contingencies that arise from and that are directly related to the operations of the discontinued operation before its disposal, such as environmental and product warranty obligations retained by the seller.”
- “The settlement of employee benefit plan obligations (pension, postemployment benefits other than pensions, and other postemployment benefits), provided that the settlement is directly related to the disposal transaction. A settlement is directly related to the disposal transaction if there is a demonstrated direct cause-and-effect relationship and the settlement occurs no later than one year following the disposal transaction, unless it is delayed by events or circumstances beyond an entity’s control.”

Disclosures

The ASU introduces several new disclosure requirements for both (1) disposals that meet the criteria for a discontinued operation and (2) individually significant disposals that do not meet these criteria. Certain disclosures are required for all types of disposals that qualify as a discontinued operation; however, the disclosure requirements for disposals of an equity method investment or an acquired business are much more limited. In addition, the disclosure requirements for private entities are more limited than those for public entities. The ASU’s implementation guidance contains a flowchart summarizing the disclosure requirements for the various disposal activities. See [Appendix B](#) for more information about disclosure requirements that apply to a discontinued operation and [Appendix C](#) for disclosure requirements that apply to all other disposals.

In the statement of cash flows, an entity must disclose either (1) operating and investing cash flows or (2) depreciation and amortization, capital expenditures, and significant operating and investing noncash items related to the discontinued operation.

Some of the noteworthy new disclosure requirements include:

- Major line items constituting the pretax profit or loss for all periods for which the discontinued operation's results of operations are reported in the income statement. Some examples of major line items are (1) revenue, (2) cost of sales, (3) depreciation and amortization, and (4) interest expense.
- For most discontinued operations, an entity must disclose either of the following in the statement of cash flows or the notes to the financial statements:
 - Operating and investing cash flows for the periods for which the discontinued operation's results of operations are reported in the income statement.
 - Depreciation and amortization, capital expenditures, and significant operating and investing noncash items for the periods for which the discontinued operation's results of operations are reported in the income statement.

Editor's Note: During deliberations of the ASU's guidance, some Board members noted that disclosure of investing and operating cash flows is more meaningful than disclosure of depreciation and amortization, capital expenditures, and significant noncash items. However, the cash flow disclosures could present a significant challenge for entities that have a centralized cash management process (since these entities do not typically segregate their invoices or purchase orders at the business unit or operating unit level) and may be difficult to provide in a timely manner and without undue effort. Therefore, the Board decided to provide entities with the above disclosure option.

- "If the discontinued operation includes a noncontrolling interest, the pretax profit or loss . . . attributable to the parent for the periods in which" the discontinued operation's results of operations are reported in the income statement.
- "For the initial period in which the disposal group is classified as held for sale and for all prior periods presented in the statement of financial position, a reconciliation of" (1) total assets and total liabilities of the discontinued operation that are classified as held for sale in the notes to the financial statements to (2) "[t]otal assets and total liabilities of the disposal group classified as held for sale that are presented separately on the face of the [balance sheet]."
- "For the periods in which the results of operations of the discontinued operation are reported," a reconciliation of (1) the pretax profit or loss for disposals and major line items constituting the profit or loss presented in the notes to the financial statements to (2) the "after-tax profit or loss from discontinued operations presented on the face of the [income] statement."
- Entities that have significant continuing involvement with a discontinued operation after the disposal date must provide additional disclosures regarding the nature of activities, including cash flows from or to the discontinued operation.
- For disposal of an individually significant component that does not meet the definition of a discontinued operation, all entities must disclose pretax profit or loss reported in the income statement for the period in which the disposal group is sold or is classified as held for sale. In addition, public entities must also disclose pretax profit or loss for all prior periods presented in the income statement.

These disclosures are required for both interim and annual reporting periods.

Effective Date and Transition

Public business entities, as well as not-for-profit entities that have issued, or that are conduit bond obligors for, securities that are traded, listed, or quoted on an exchange or over the counter, will apply the new ASU prospectively to all disposals (or classifications as held for sale) that occur in annual periods (and interim periods therein) beginning

on or after December 15, 2014. For all other entities, the new ASU will be effective prospectively for annual periods beginning on or after December 15, 2014, and interim periods thereafter. Early adoption is permitted for any annual or interim period for which an entity's financial statements have not yet been previously issued or made available for issuance. Entities are prohibited from applying the new ASU to any component, equity method investment, or acquired business that is classified as held for sale before the adoption date.

Early adoption is permitted for any annual or interim period for which an entity's financial statements have not yet been previously issued or made available for issuance.

Editor's Note: Public and nonpublic entities that elect to early adopt the ASU can adopt it prospectively at the beginning of an interim or annual period as long as the interim or annual financial statements have not been issued or made available for issuance. For example, if an entity's annual period commenced on October 1, 2013, and the entity has issued its first-quarter interim financial statements, the entity can elect to early adopt the standard on January 1, 2014 (the beginning of its second quarter), as long as the second-quarter financial statements have not been issued or made available for issuance. Further, in certain situations, a component may be disposed of or meet the held-for-sale criteria after the last issued annual or interim financial statements but was disclosed in the financial statements or elsewhere (i.e., in a Form 8-K) as a subsequent event. In this situation, an entity can still early adopt the ASU at the beginning of its next interim or annual period for which financial statements have not been previously issued or made available for issuance (on January 1, 2014, in the example above) and can apply the new guidance to all disposals that met the criteria after the adoption date even if the disposals were previously reported as a subsequent event.

Because nonpublic entities will be required to apply the guidance in annual periods beginning on or after December 15, 2014, and interim periods thereafter (i.e., January 1, 2016, for calendar-year entities), some nonpublic entities that issue interim financial statements may encounter a situation in which a component of an entity that is classified as a discontinued operation under ASC 205-20 in its interim financial statements under existing guidance may need to be reclassified to continuing operations in its annual financial statements upon adoption of the new guidance. Nonpublic entities could avoid this situation by electing to early adopt this ASU as of the beginning of its fiscal year and report both the interim and annual periods under the new guidance.

Appendix A — Examples of Disposals in Which the Discontinued-Operation Criteria Are Met

The examples below, which are reproduced from ASC 205-20-55-84 through 55-92, illustrate disposals of a component of an entity or groups of components of an entity that represent a change in business strategy that has or will have a major effect on the entity's operations and financial results.

Example 1: Consumer Products Manufacturer

An entity manufactures and sells consumer products that are grouped into five major product lines. Each product line includes several brands that comprise operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, for that entity, each major product line includes a group of components of the entity. [ASC 205-20-55-84]

The entity has experienced high growth in its discount cleaning product line that has lower price points than its premium cleaning product line. Total revenues from the discount cleaning product line are 15 percent of the entity's total revenues; however, the discount cleaning product line will require significant future investments to increase its profits. Therefore, the entity decides to shift its strategy of selling cleaning products at multiple price points and focus solely on selling cleaning products at a premium price point. As a result, the entity decides to sell the discount cleaning product line. [ASC 205-20-55-85]

Because the entity shifts its strategy of offering discount cleaning products to consumers and because the discount cleaning product line is one of five major product lines that is a major part of the entity's operations and financial results, the disposal represents a strategic shift that is reported in discontinued operations. [ASC 205-20-55-86]

Example 2: Processed and Packaged Goods Manufacturer

An entity manufactures and sells food products that are grouped into five major geographical areas (Europe, Asia, Africa, the Americas, and Oceania). Each major geographical area includes several brands that comprise operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, for that entity, each major geographical area includes a group of components of the entity. [ASC 205-20-55-87]

The entity has experienced slower growth in its operations located in the Americas, which accounts for 20 percent of the entity's total assets. Therefore, the entity decides to shift its strategy of selling food products in that geographical area and focus its resources on manufacturing and marketing food products in its other four higher growth geographical areas. As a result, the entity decides to sell its operations in the Americas. [ASC 205-20-55-88]

Because the entity's operations in the Americas is one of five major geographical areas that is a major part of the entity's operations and financial results, the disposal represents a strategic shift that is reported in discontinued operations. [ASC 205-20-55-89]

Example 3: General Merchandise Retailer

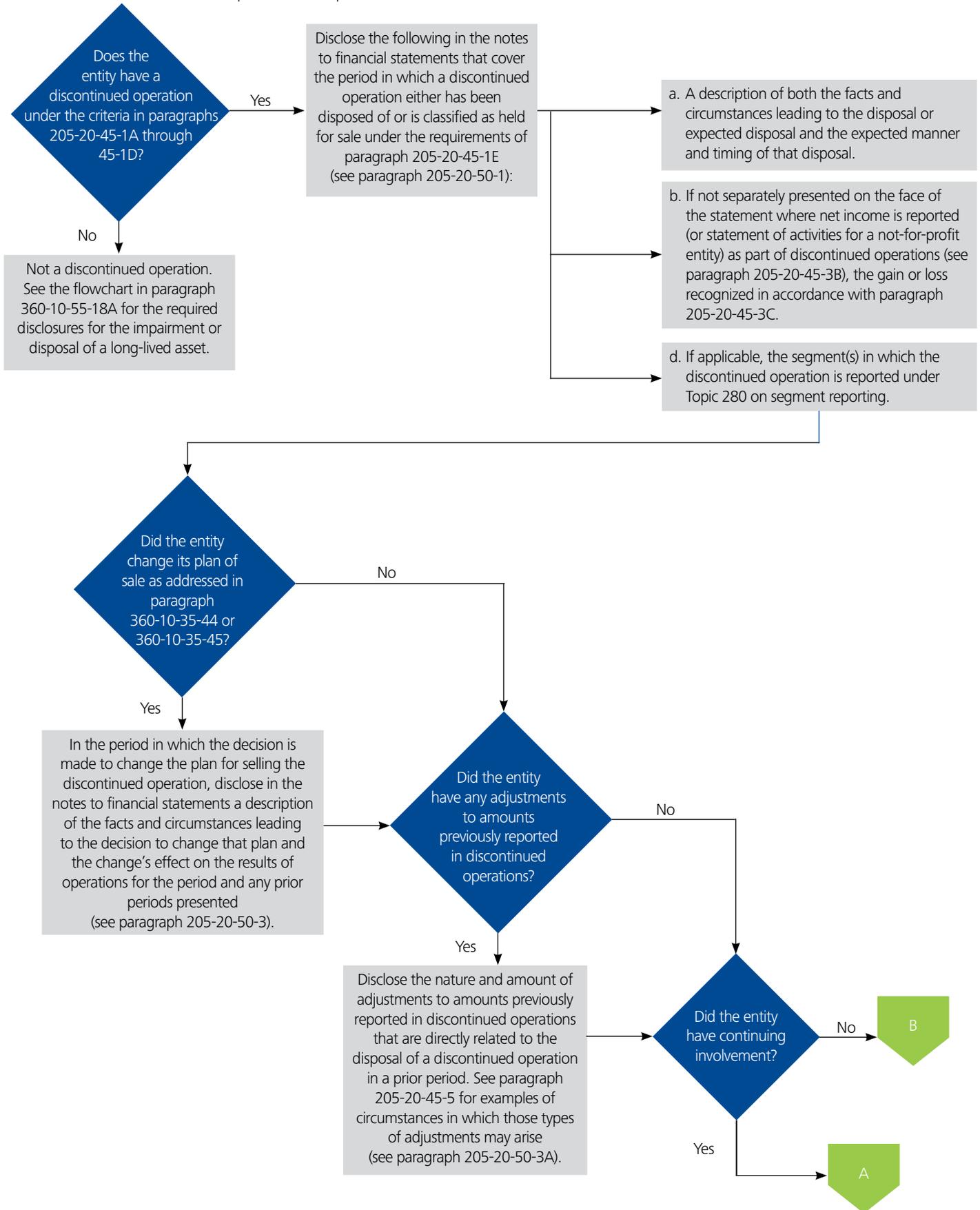
An entity that is a general merchandise retailer operates 1,000 retail stores in 2 different store formats—malls and supercenter stores—throughout the United States. The entity divides its stores into five major geographical regions: the Northwest, Southwest, Midwest, Northeast, and Southeast. For that entity, each retail store comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, for that entity, each retail store is a component of the entity. [ASC 205-20-55-90]

The entity has experienced declining net income at its 200 stores located in malls across all 5 major geographical regions. Historically, net income from the 200 stores in malls has been in a range of 30 to 40 percent of the entity's total net income. Total net income from the 200 stores in malls is down to 15 percent of the entity's total net income because of declining customer traffic in malls. Therefore, the entity decides to shift its strategy of selling products in malls and sell the 200 stores located in malls. [ASC 205-20-55-91]

Because the entity decides to shift its strategy of selling products in malls and focus solely on its supercenter stores and because the 200 stores located in malls are a major part of the entity's operations and financial results, the disposal represents a strategic shift that is reported in discontinued operations. [ASC 205-20-55-92]

Appendix B — Required Disclosures for a Discontinued Operation

The flowchart below was excerpted and adapted from ASU 2014-08.





Disclose information about an entity's significant continuing involvement with a discontinued operation after the disposal date. The disclosures are required until the results of operations of the discontinued operation in which an entity retains significant continuing involvement are no longer presented separately as discontinued operations in the statement where net income is reported (or statement of activities). Disclose the following for each discontinued operation in which the entity retains significant continuing involvement after the disposal date (see paragraphs 205-20-50-4A through 50-4B):

- a. A description of the nature of the activities that give rise to the continuing involvement.
- b. The period of time during which the involvement is expected to continue.
- c. For all periods presented, both the amount of any cash inflows or outflows from or to the discontinued operation after the disposal transaction and revenues or expenses presented, if any, in continuing operations after the disposal transaction that before the disposal transaction were eliminated in consolidated financial statements as intra-entity transactions.
- d. For a discontinued operation in which an entity retains an equity method investment after the disposal (the investee), information that enables users of financial statements to compare the financial performance of the entity from period to period assuming that the entity held the same equity method investment in all periods presented in the statement where net income is reported (or statement of activities). The disclosure should include all of the following until the discontinued operation is no longer reported separately in discontinued operations:

- 1. For each period presented in the statement where net income is reported (or statement of activities) after the period in which the discontinued operation was disposed of, the pretax income of the discontinued operation in which the entity retains an equity method investment.
- 2. The entity's ownership interest in the discontinued operation before the disposal transaction.
- 3. The entity's ownership interest in the investee after the disposal transaction.
- 4. The entity's share of the income or loss of the investee in the period(s) after the disposal transaction and the line item in the statement where net income is reported (or statement of activities) that includes the income or loss.



Which criterion does the discontinued operation meet?

205-20-45-1B through 45-1C 205-20-45-1D

Was the discontinued operation an equity method investment before the disposal?

Yes No

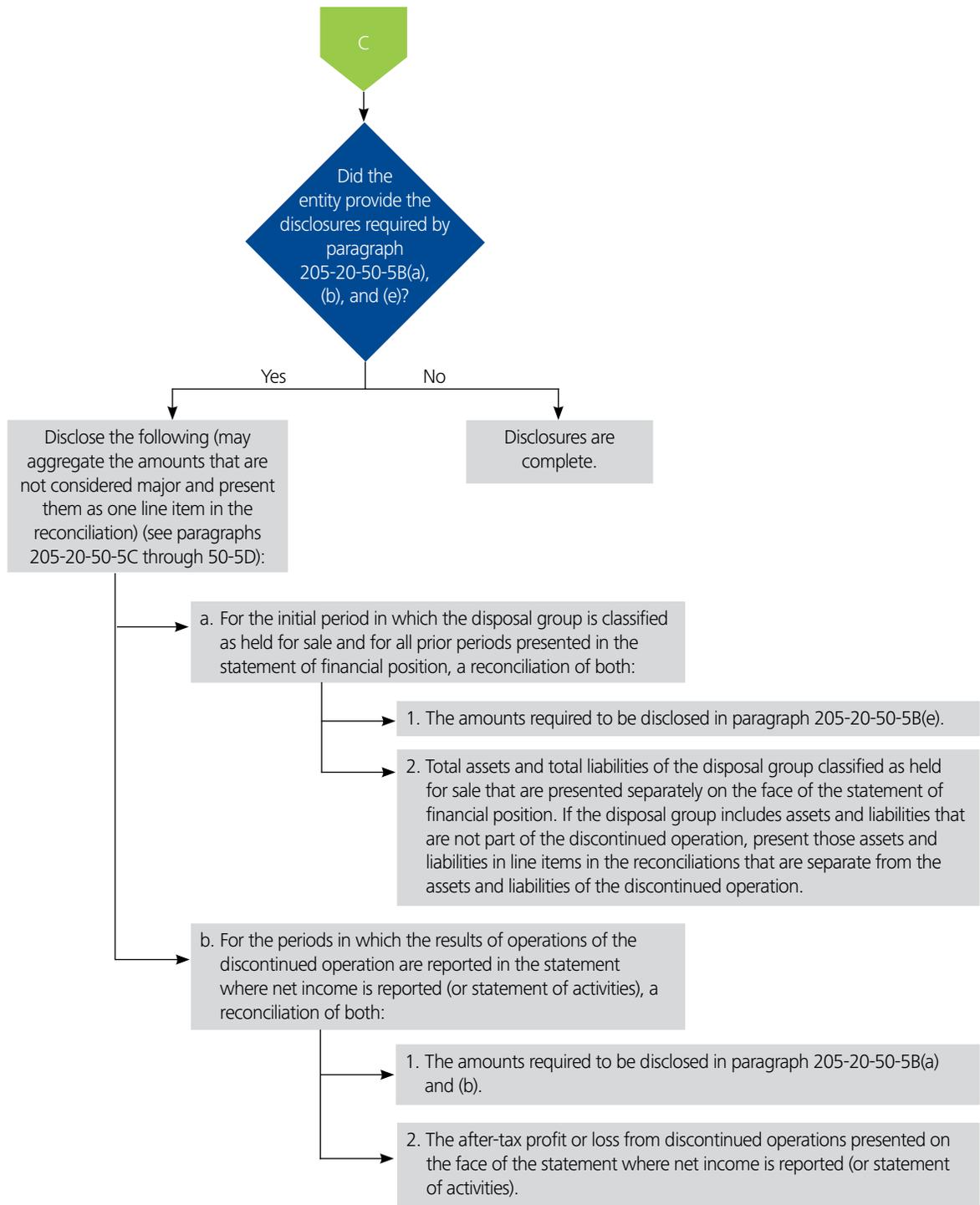
Disclosures are complete for a discontinued operation that is a business or nonprofit activity held for sale at acquisition.

Disclose the summarized information about the assets, liabilities, and results of operations of the investee if that information was disclosed in financial reporting periods before the disposal in accordance with paragraph 323-10-50-3(c) (see paragraph 205-20-50-7).

To the extent not presented on the face of the financial statements as part of discontinued operations, disclose all of the following in the notes to financial statements for the periods in which the results of operations of the discontinued operation are presented in the statement where net income is reported (or statement of activities) or for the period in which the discontinued operation is classified as held for sale and all prior periods presented in the statement of financial position (as applicable) (see paragraph 205-20-50-5B):

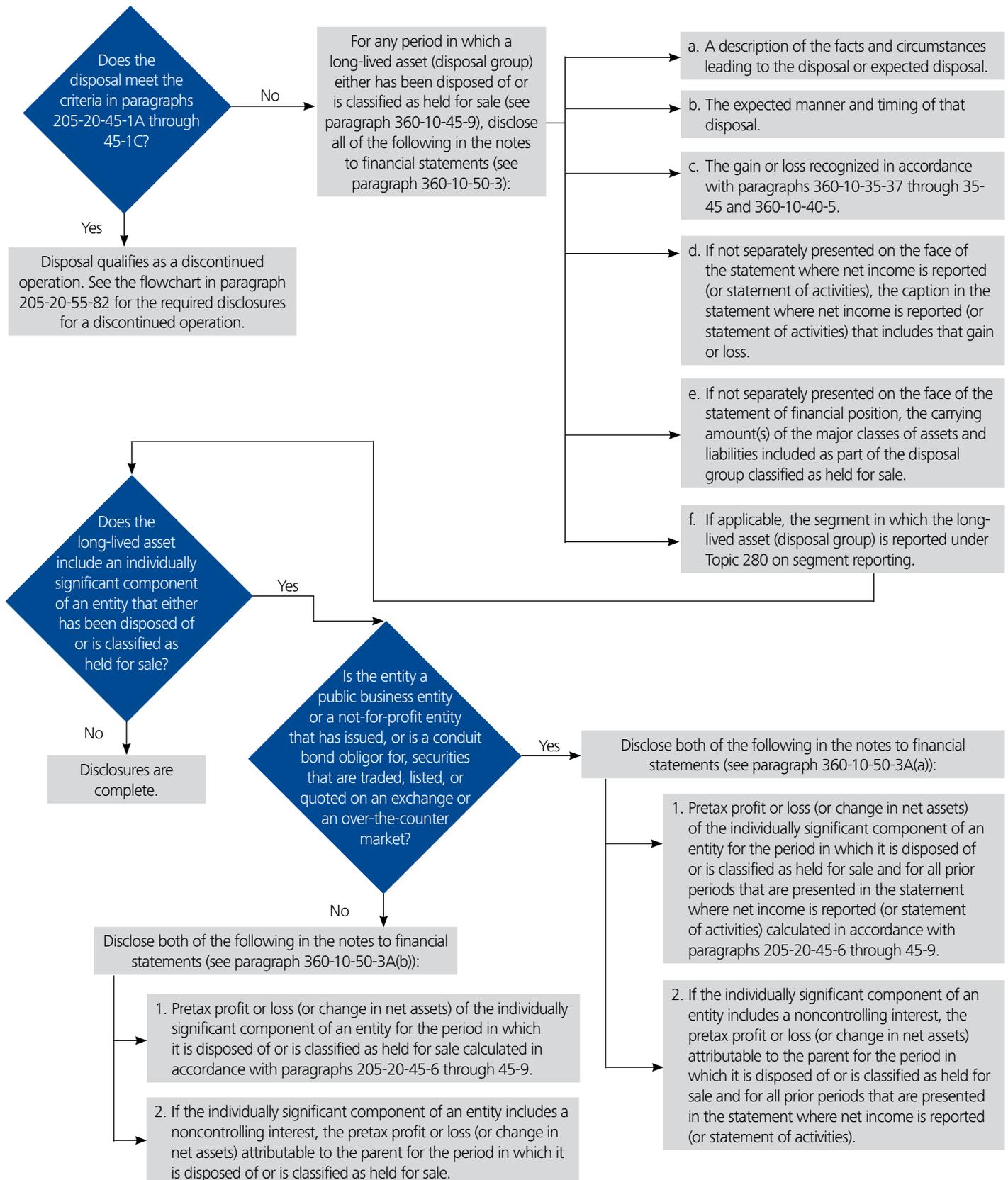
- a. The pretax profit or loss (or change in net assets) of the discontinued operation.
- b. The major classes of line items constituting the pretax profit or loss (or change in net assets) of the discontinued operation.
- c. Either the total operating and investing cash flows of the discontinued operation or the depreciation, amortization, capital expenditures, and significant operating and investing noncash items of the discontinued operation.
- d. If the discontinued operation includes a noncontrolling interest, the pretax profit or loss (or change in net assets) attributable to the parent.
- e. The carrying amount(s) of the major classes of assets and liabilities included as part of a discontinued operation classified as held for sale.





Appendix C — Required Disclosures for the Disposal of an Asset and Component of an Entity

The flowchart below was excerpted and adapted from ASU 2014-08.



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