

Heads Up

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Refining Revenue

FASB Makes Narrow-Scope Amendments to Revenue Standard and Provides Practical Expedients

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On May 9, 2016, the FASB issued [ASU 2016-12](#),¹ which amends certain aspects of the Board's May 2014 revenue standard, [ASU 2014-09](#)² (the "new revenue standard"). The amendments address certain implementation issues identified by the TRG³ and clarify, rather than change, the new revenue standard's core revenue recognition principles. Changes include the following:

- *Collectibility* — ASU 2016-12 clarifies the objective of the entity's collectibility assessment and contains new guidance on when an entity would recognize as revenue consideration it receives if the entity concludes that collectibility is not probable.
- *Presentation of sales tax and other similar taxes collected from customers* — Entities are permitted to present revenue net of sales taxes collected on behalf of governmental authorities (i.e., to exclude from the transaction price sales taxes that meet certain criteria).
- *Noncash consideration* — An entity's calculation of the transaction price for contracts containing noncash consideration would include the fair value of the noncash consideration to be received as of the contract inception date. Further, subsequent changes in the fair value of noncash consideration after contract inception would be included in the transaction price as variable consideration (subject to the variable consideration constraint) only if the fair value varies for reasons other than its form.
- *Contract modifications and completed contracts at transition* — The ASU establishes a practical expedient for contract modifications at transition and defines completed contracts as those for which all (or substantially all) revenue was recognized under the applicable revenue guidance before the new revenue standard was initially applied.
- *Transition technical correction* — Entities that elect to use the full retrospective transition method to adopt the new revenue standard would no longer be required to disclose the effect of the change in accounting principle on the period of adoption (as is currently required by ASC 250-10-50-1(b)(2));⁴ however, entities would still be required to disclose the effects on preadoption periods that were retrospectively adjusted.

¹ FASB Accounting Standards Update No. 2016-12, *Narrow-Scope Improvements and Practical Expedients*.

² FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers (Topic 606)*; issued by the IASB as IFRS 15, *Revenue From Contracts With Customers*.

³ The transition resource group (TRG) for revenue recognition was established by the FASB and IASB to seek and provide feedback on potential issues related to implementation of the new revenue standard. Early this year, the IASB announced that it completed its decision-making process related to clarifying the new revenue standard and that it no longer plans to schedule TRG meetings for IFRS constituents.

⁴ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the FASB Accounting Standards Codification."

Editor’s Note: The ASU notes that in light of the following, there may be “minor differences in financial reporting outcomes between GAAP and IFRS” as a result of the ASU’s amendments:

- IFRS 15 does not allow a policy election for the presentation of sales taxes on a net basis.
- IFRS 15 does not prescribe the measurement date for noncash consideration.
- The different dates associated with an entity’s application of (1) the practical expedient for contract modifications and (2) the term “completed contracts” for transition purposes.

The ASU’s effective date and transition requirements are the same as those in the new revenue standard as amended by ASU 2015-14,⁵ which delays the effective date of the new revenue standard by one year and permits early adoption on a limited basis.

Editor’s Note: With the exception of certain technical corrections, the issuance of ASU 2016-12 completes the FASB’s deliberations of clarifications to the new revenue standard over the past year. Such clarifications also include recently issued ASUs related to the new revenue standard’s guidance on (1) principal-versus-agent assessments⁶ and (2) identifying performance obligations and licenses.⁷

Accordingly, entities will need to assess their transition to each ASU as they implement the new revenue standard, and they should also evaluate how TRG and SEC activities may affect their adoption of the new revenue standard. For additional information on the TRG’s meetings, see Deloitte’s March 2016 *TRG Snapshot*, which summarizes revenue implementation issues discussed to date, and April 2016 *TRG Snapshot*, which discusses the TRG’s April 2016 meeting. In addition, see the [appendix](#) below, which highlights recent SEC staff remarks for SEC registrants to consider related to disclosures, filings of certain registration statements, and consultations with the SEC’s Office of the Chief Accountant (OCA).

Collectibility

Background

Step 1 of the new revenue standard (ASC 606-10-25-1(e)) requires an entity to assess whether it “is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.”⁸ The collectibility threshold is assessed at contract inception (and will continue to be assessed if the threshold was not originally met). If collectibility is not probable, the entity would not be permitted to recognize revenue under ASC 606-10-25-7 unless either of the following conditions is met:

- a. The entity has no remaining obligations to transfer goods or services to the customer, and all, or substantially all, of the consideration promised by the customer has been received by the entity and is nonrefundable.
- b. The contract has been terminated, and the consideration received from the customer is nonrefundable.

During the FASB’s outreach, stakeholders indicated that they had questions about how to apply this guidance in situations in which (1) a contract does not meet the probability requirement and (2) an entity receives consideration from the customer for the entity’s performance to date. Specifically, some stakeholders asked the FASB to clarify whether revenue can be recognized when a portion of

⁵ FASB Accounting Standards Update No. 2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date*.

⁶ See Deloitte’s March 22, 2016, *Heads Up* for additional information.

⁷ For additional information, see Deloitte’s April 15, 2016, *Heads Up*.

⁸ The ASU added the wording “substantially all of” to the text in ASC 606-10-25-1(e).

consideration is collected, the contract is legally valid, and the entity is able to reduce its credit risk exposure (e.g., the entity may cease to provide goods or services if the customer does not pay). Further, other stakeholders found it difficult to determine whether, under certain circumstances, a contract had been terminated (i.e., whether the second condition above had been met).

Editor’s Note: Entities will need to apply significant judgment in interpreting the new phrase “substantially all of” in ASC 606-10-25-1(e). The ASU’s new examples (ASC 606-10-55-95 through 55-98L) help entities apply this guidance.

Key Provisions of the ASU

The ASU adds a third criterion to ASC 606-10-25-7 (ASC 606-10-25-7 (c)) noting that if the criteria in ASC 606-10-25-7 are not met, revenue can be recognized if (1) the entity has transferred to the customer control of goods or services to which the consideration received is related, (2) the entity has stopped transferring additional goods and services and is not obligated under the contract to transfer any further goods or services, and (3) “consideration received from the customer is nonrefundable.”

Editor’s Note: During the FASB’s outreach related to the proposed amendments, stakeholders raised concerns about the determination of whether a contract is terminated, including situations in which the entity stops delivering goods or services to the customer because the customer has not made payments under the contract. For example, some stakeholders noted that it was unclear whether the entity’s process of pursuing delinquent payments from the customer would suggest that such a contract has not been terminated (and therefore would not meet the criterion for revenue recognition under ASC 606-10-25-7(b)).

Rather than clarifying when a contract has been terminated (such clarification often is subject to legal interpretation), the FASB added ASC 606-10-25-7(c). However, in assessing whether an obligation to deliver further goods or services exists, an entity must carefully analyze the contractual terms and may need to obtain a legal interpretation in some instances.

The ASU also adds implementation guidance to ASC 606 to help entities determine whether collectibility is probable under step 1 of the new revenue standard (i.e., under ASC 606-10-25-1(e)). For example, ASC 606-10-55-3A and 55-3B note that the objective of the collectibility assessment is for entities to determine whether there is a substantive transaction between the entity and the customer. In addition, this guidance clarifies that the evaluation of collectibility:

- Is an assessment of whether the customer has the intent and ability to pay the consideration promised for the goods or services that the entity will transfer (and for which the entity will receive substantially all of this consideration) rather than an assessment of whether it will collect from the customer consideration for all goods and services in the contract (i.e., for the total transaction price).
- Is “not necessarily based on the customer’s ability and intention to pay the entire amount of promised consideration for the entire duration of the contract.” Therefore to assess collectibility under step 1, an entity may look to a subset of the goods and services identified in the contract; however, ASC 606-10-25-3 specifies that if an entity concludes that a revenue contract meets all of the step 1 criteria (i.e., including that collectibility is probable), “the remainder of the guidance in [the new revenue standard] shall be applied to **all** of the promised goods or services in the contract” (emphasis added).
- Involves judgment because it is, in part, a “forward-looking assessment”; therefore, an entity should consider all facts and circumstances in performing this assessment, including its customary business practices and knowledge of its customer.

Further, the ASU indicates in ASC 606-10-55-3C that on the basis of the contract's terms or an entity's customary business practices, the entity may conclude that its exposure to the customer's credit risk has been reduced to an amount lower than the total consideration promised under the contract. However, the ASU notes that an entity should not consider repossession when evaluating its ability to mitigate its credit risk. Examples of factors that may mitigate credit risk include:

- *Payment terms* — The ASU cites instances in which a customer is required to pay consideration before the entity transfers goods or services to the customer. The ASU notes that such prepayments "would not be subject to credit risk."
- *The right and ability to cease transfer of further goods or services under the contract for circumstances in which a customer fails to pay when payments are due* — Collectibility would be assessed on the basis of the consideration for goods and services that would be transferred to the customer. The ASU indicates that, as a result, "if the customer fails to perform as promised and consequently, the entity would respond . . . by not transferring additional goods or services to the customer, the entity would not consider the likelihood of payment for the promised goods or services that will not be transferred under the contract."

Editor's Note: Two Board members objected to issuance of the ASU, primarily because of the FASB's decision to reject moving the collectibility assessment from step 1 to step 5 of the new revenue model (i.e., change it from a criterion for evaluating whether a contract with a customer exists to one used to determine when to recognize revenue). These Board members believe that, unlike current U.S. GAAP, the proposed changes would not permit entities to recognize revenue on a cash basis. As a result, the proposed amendments could continue to lead to situations in which an entity would record a liability for which no obligation exists (i.e., a liability would be recognized for cash received from a customer but the related obligation was satisfied because goods and services were transferred).

The ASU's amendments are intended to help an entity apply the collectibility assessment guidance in circumstances in which the entity may limit its exposure to a customer's credit risk to an amount that is less than the total consideration under the contract. However, the amended guidance is not equivalent to the guidance on the cash basis under existing GAAP. Consequently, in its assessment of collectibility under the new revenue standard, an entity will most likely need to use significantly more judgment and will encounter more complexities than it does under current GAAP (particularly if it uses the cash basis under current GAAP because collectibility for some contracts is not reasonably assured).

Presentation of Sales Taxes and Similar Taxes Collected From Customers

Background

Under step 3 of the new revenue standard, the transaction price is the "amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties." Stakeholders have questioned whether sales taxes and similar taxes ("sales taxes") should be excluded from the transaction price when such taxes are collected on behalf of tax authorities.

The new revenue standard provides guidance on assessing whether an entity is a principal or an agent⁹ in a transaction and, therefore, whether sales taxes should be presented gross or net within revenue. The analysis is further complicated by the sales tax in each tax jurisdiction (which would include all taxation levels in both domestic and foreign governmental jurisdictions), especially for entities that operate in a significant number of jurisdictions.

Key Provisions of the ASU

The ASU permits entities to exclude from the transaction price all sales taxes that are assessed by a governmental authority and that are “imposed on and concurrent with a specific revenue-producing transaction and collected by the entity from a customer (for example, sales, use, value added, and some excise taxes).” However, such an accounting policy election does not apply to taxes assessed on “an entity’s total gross receipts or imposed during the inventory procurement process.” An entity that elects to exclude sales taxes is required to provide the accounting policy disclosures in ASC 235-10-50-1 through 50-6.

Editor’s Note: The guidance aligns the scope of sales taxes in the new revenue standard with that in ASC 605-45-15-2(e). Further, an entity that does not elect to present all sales taxes on a net basis would be required to assess, for every tax jurisdiction, whether it is a principal or an agent in the sales tax transaction and would present sales taxes on a gross basis if it is a principal in the jurisdiction and on a net basis if it is an agent.

Noncash Consideration

Background

When providing goods or services, an entity may receive noncash consideration from its customers (e.g., goods, services, shares of stock). Step 3 of the new revenue standard requires entities to include the fair value of the noncash consideration in the transaction price. Further, the guidance states that changes in the fair value of noncash consideration for reasons other than its form would be subject to the variable consideration constraint in ASC 606-10-32-11 through 32-13.

During the FASB’s outreach, stakeholders indicated that they were unclear about the measurement date in the determination of the fair value of noncash consideration received in a contract with a customer. Further, they questioned the applicability of the variable consideration constraint when changes in the fair value of the noncash consideration are due both to (1) its form (e.g., stock price changes attributable to market conditions) and (2) reasons other than its form (e.g., additional shares of stock that may become due on the basis of a contingent event).

Key Provisions of the ASU

The ASU defines the measurement date as the “contract inception” date and clarifies that this is the date on which the criteria in step 1 are met (i.e., the criteria in ASC 606-10-25-1). In addition, the transaction price does not include any changes in the fair value of the noncash consideration after the contract inception date that are due to its form. Further, the ASU states that if changes in noncash consideration are due both to its form and to reasons other than its form, only variability resulting from changes in fair value that are due to reasons other than the consideration’s form are included in the transaction price as variable consideration (and thus also subject to the variable consideration constraint).

⁹ See FASB Accounting Standards Update No. 2016-08, *Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*, and Deloitte’s March 22, 2016, related [Heads Up](#).

Example — Noncash Consideration in the Form of Publicly Traded Common Stock

As part of a revenue contract with a customer for the delivery of goods, an entity is entitled to receive 500 shares of its customer's common stock when all of the goods are provided to the customer. In addition, if the entity delivers all goods within 90 days, it will receive an additional 100 shares of the customer's common stock. The changes in the fair value of the noncash consideration may vary between the contract inception date and the delivery of goods as a result of (1) the form of the common stock (i.e., because of changes in the market value) and (2) reasons other than its form (i.e., the quantity of shares that the entity will receive may vary because delivery occurs in 90 days).

The ASU clarifies that the transaction price would include as variable consideration (subject to the variable consideration constraint) only changes in fair value that are due to reasons other than the consideration's form, which, in this example, is the quantity of shares to be received by the entity. Consequently, in this example, increases or decreases in the market value of the common stock would not be recorded as adjustments to the transaction price (i.e., revenue).

In addition, some stakeholders asked the Board to clarify how the fair value of noncash consideration should be measured on the contract inception date. As noted in paragraph 39 of the ASU's Basis for Conclusions, the Board elected not to clarify the measurement process because it believes that "the concept of fair value exists in other parts of [ASC] 606," and an entity will need to use judgment in determining fair value.

Contract Modifications and Completed Contracts at Transition

Background

When initially adopting the new revenue standard, entities may apply either the full or the modified retrospective transition method. Either method requires entities to evaluate the impact of contract modifications before the date on which the new revenue standard is initially applied. Under the new revenue standard, the subsequent accounting for contract modifications may result in (1) a separate contract, (2) a termination of an old contract and the creation of a new contract, and (3) a cumulative catch-up adjustment.

During the FASB's outreach, stakeholders expressed concerns regarding situations in which an entity applies the transition guidance and has a high volume of customer contracts (especially long-duration contracts) that may be modified frequently. In particular, stakeholders have questioned whether the costs of assessing preadoption modifications may exceed the benefits because of the limited usefulness of applying the contract modification guidance to periods before the date of initial adoption. In addition, stakeholders were uncertain about when a contract is considered completed for transition purposes.

Key Provisions of the ASU

The ASU provides a practical expedient for situations in which an entity uses the retrospective transition method to evaluate contract modifications that occurred before the beginning of the earliest period presented. The practical expedient does not require entities to evaluate the impact of each contract modification before the beginning of the earliest period presented. The ASU adds the following guidance to ASC 606-10-65-1(f):

For contracts that were modified before the beginning of the earliest reporting period presented in accordance with the [new revenue standard], an entity need not retrospectively restate the contract for those contract modifications in accordance with [ASC] 606-10-25-12 through 25-13. Instead, an entity

shall reflect the aggregate effect of all modifications that occur before the beginning of the earliest period presented in accordance with the [new revenue standard] when:

- i. Identifying the satisfied and unsatisfied performance obligations
- ii. Determining the transaction price
- iii. Allocating the transaction price to the satisfied and unsatisfied performance obligations.

Entities are also permitted to apply the practical expedient if they elect the modified retrospective transition approach for contract modifications to either (1) all contracts as of the initial application date or (2) all contracts that have not been completed as of the initial application date. Whichever transition method is used, an entity that elects to apply the practical expedient must apply it consistently to all contracts and disclose the method it applies.

Editor's Note: We believe that the amended transition guidance addressing contract modifications is intended to permit an entity to evaluate a contract (and allocate the transaction price accordingly) on the basis of the performance obligations that exist as of the date of initial application. In addition, the entity would not need to consider the effects that contract modifications would have had on the revenue recognized before the date of the new revenue standard's initial application. That is, an entity can use hindsight to determine the performance obligations and transaction price associated with contracts in place as of the date of initial application of the new standard. Further, the amount of the transaction price allocated to satisfied or partially satisfied performance obligations would be accounted for as transition adjustments (according to the entity's method of transition), and unsatisfied performance obligations would be recognized as revenue when control is transferred in accordance with the new revenue standard.

The ASU also clarifies that a completed contract is one in which all (or substantially all) of the revenue has been recognized under the applicable revenue guidance before the new revenue standard is initially applied.

Appendix — Additional Transition Considerations for SEC Registrants

On May 5, 2016, Wesley Bricker, deputy chief accountant in the OCA, [spoke](#) at the 2016 Baruch College Financial Reporting Conference in New York City. Mr. Bricker commented on transition-period activities related to several of the FASB's recently issued accounting standards, including the new revenue standard. His remarks addressed three significant reporting and disclosure matters that broadly affect SEC registrants: (1) SAB Topic 11.M¹⁰ disclosures, (2) the requirement for revised financial statements in a registration statement, and (3) consultations with the OCA.

SAB Topic 11.M Disclosures

Mr. Bricker emphasized the importance of providing investors with disclosures that explain the impact that new accounting standards are expected to have on an entity's financial statements ("transition disclosures").¹¹ Such disclosures provide investors with the information necessary to determine the effects of adopting a new standard and how the adoption will affect comparability period over period. Mr. Bricker highlighted the importance of "timely investor education and engagement" and presented examples of both successful and unsuccessful past transitions to new accounting standards. He indicated that transparent disclosure of anticipated impacts of a new standard in multiple reporting periods preceding its adoption has prevented market participants from reacting adversely to significant accounting changes. In a manner consistent with previous SEC staff comments on transition disclosures,¹² Mr. Bricker reiterated that "[i]nvestors should expect the level of disclosures to increase as companies make further progress in their implementation plans" in connection with newly issued standards.

Requirement for Revised Financial Statements in a Registration Statement

Registrants planning to use the full retrospective method of adoption have expressed concerns about the requirement to provide revised financial statements for the first quarter in which the new revenue standard is adopted but before filing a Form S-3¹³ registration statement. If a registrant elects the full retrospective method of adoption and subsequently files a registration statement that incorporates by reference interim financial statements reflecting the impact of the adoption of the new revenue standard, it would be required to retrospectively revise its annual financial statements in its Form 10-K. Those financial statements would include one more year of retrospectively revised financial statements than the number of years that would be required if the registrant did not file a registration statement (the "fourth year").

For example, a calendar-year-end registrant adopts the new revenue standard on January 1, 2018, by using the full retrospective method and files its first quarter Form 10-Q on May 1, 2018. If the registrant files a Form S-3 on June 1, 2018, it is required under Form S-3, Item 11(b), to revise its financial statements retrospectively for the years ending 2017, 2016, and 2015 since financial statements for these years are required in the registration statement. If the registrant did not file a Form S-3, it would only be required to revise 2017 and 2016 retrospectively when it files its 2018 Form 10-K.

Mr. Bricker indicated that the SEC staff is aware of these concerns and acknowledged that, while this requirement applies to any retrospective change, the "pervasive impact of the new revenue standard amplifies the issue." He noted that the new revenue standard refers to current GAAP and therefore contemplates an impracticability exception to retrospective application if, "after making every reasonable effort to do so," a registrant concludes that it is not practicable to apply the standard retrospectively to all periods required to be presented in a registration statement.¹⁴ Mr. Bricker emphasized that the OCA is available for consultation.

¹⁰ SEC Staff Accounting Bulletin (SAB) No. 74 (Topic 11.M), "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period."

¹¹ See SAB Topic 11.M.

¹² See Deloitte's December 15, 2015, [Heads Up](#) for more information.

¹³ While Mr. Bricker referred to Item 11(b) of Form S-3, other registration statements, such as Form S-4, include similar requirements.

¹⁴ See ASC 250-10-45-9. While Mr. Bricker's remarks only referred to the guidance in ASC 250-10-45-9(a), ASC 250-10-45-9(b) and (c) also describe scenarios in which a conclusion might be supported that retrospective application is impracticable. Namely, ASC 250-10-45-9(b) states, "Retrospective application requires assumptions about management's intent in a prior period that cannot be independently substantiated." And ASC 250-10-45-9(c) states, "Retrospective application requires significant estimates of amounts, and it is impossible to distinguish objectively information about those estimates that both: (1) Provides evidence of circumstances that existed on the date(s) at which those amounts would be recognized, measured, or disclosed under retrospective application [and] (2) Would have been available when the financial statements for that prior period were issued."

Editor's Note: We understand that the SEC staff expects registrants to discuss their conclusions regarding impracticability with the staff in advance of filing a registration statement in which they conclude that retrospective application to the "fourth year" is impracticable.

Consultations With the OCA

Mr. Bricker also suggested that registrants consider consultation with the OCA, especially when faced with "complex, or innovative transactions for which no clear guidance exists," or when contemplating an accounting treatment that deviates from the treatment supported by the TRG. Noting that the OCA has already begun conducting consultations on the adoption of the new revenue standard, he highlighted some of its recent decisions, including its:

- Objection to the recognition of revenue on "likely" contracts (i.e., before the existence of enforceable rights and obligations). Mr. Bricker reminded the audience that it would be "inappropriate to recognize revenue for a contract before the contract exists with enforceable rights and obligations."
- Objection to the combination of contracts with different customers (or their related parties). He reminded the audience that "the guidance in Topic 606 explicitly limits what contracts may be combined."
- Support for the continued application of current guidance on loss contracts. Mr. Bricker indicated that it was not the FASB's intention "to change practice with respect to the timing of loss recognition for those contracts in the scope of Topic 605-35 (as amended)."

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