Implementation of ASC 606, 842 and 715

May 23, 2018
Disclaimer

All information provided is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation. Any similarity between any depiction in this course and any actual event, person or entity is purely coincidental.
Agenda

1. Introduction and overview
2. Implementation of ASC 606
3. Implementation of ASC 842
4. Implementation of ASC 715
Polling Question #1

As it relates to the adoption of ASC 606 this past quarter, what was the impact to your Company’s financial statements:

§ Material impact to the financial statements
§ Non-material impact to the financial statements
Polling Question #2

As it relates to the adoption of ASC 606 this past quarter, what was the impact to your Company’s internal control environment:

§ Material change in our internal controls
§ Not a material change in our internal controls
A look back at what Companies said

What have companies said about the time and effort to implement the new revenue standard?

“ASU 2014-09 is complex and implementation time for many entities has shown signs of being lengthy, so more time is needed.”
Letter to FASB dated May 18, 2015, from CalCPA

“Deferral is necessary... the resulting impact of the new standard on companies’ diverse processes, systems, internal controls, policies, compensation programs, training and communications (both internal and external). $300 million each on accounting technology...”
Letter to FASB dated May 18, 2015, from Raytheon

“Based on our efforts to analyze and implement the new guidance, we believe a delay of at least one year is necessary to mitigate financial reporting risk and ensure the resulting accounting is supported by internal controls that are appropriately designed and effectively operating.”
American Express letter to FASB dated May 29, 2015

“...We recommend a two-year deferral, as this would be beneficial to entities applying the guidance retrospectively”
Verizon letter to FASB dated May 29, 2015
A look back at what the SEC said

<table>
<thead>
<tr>
<th>SEC Deputy Chief Accountant comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall state of readiness is lagging - 75% of companies in recent survey had not completed their initial impact assessment and, of those, a third had not even begun the assessment.</td>
</tr>
<tr>
<td>Audit committees need to be involved and informed of management’s detailed implementation plans and make sure the company has sufficient resources to complete the work timely</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other SEC comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>All companies will experience some degree of change, which may include changes to disclosures, additional estimates and judgment, processes, systems or controls.</td>
</tr>
<tr>
<td>Some companies are achieving good results by taking a bottom-up approach to implementation, which begins with the identification of different revenue streams and contracts.</td>
</tr>
</tbody>
</table>
## Stakeholders and involved parties

### Core Project Team
- Audit Committee Oversight
- Steering Committee
- PMO
- Multi-location Considerations
  - Accounting and Reporting
  - IT
  - Tax
  - Shared Services
  - SOX Office

### Other Internal
- Investor Relations
- Business Operations
  - Sales (Contracting/Pricing)
  - Legal
  - Human Resources
  - Internal Audit
  - Financial Planning & Analysis

### External
- Lender
- Investor Analyst
- External Audit
- Customers
- Regulators
- Industry Peers
Revenue implementation - Change is challenging

Phase 1: Assess
- High level assessment
  - Scoping
- Accounting Diagnostic
  - Initial Evaluation of Processes and Systems
  - Prioritize Impacts and Define Workstreams
  - Formalize Steering Committee, Communication Plan and Key Milestones
- Detailed impact assessment
  - Contract Reviews
  - Accounting Gaps
    - Accounting Evaluation
    - White Papers
    - Taxes
    - Disclosures
  - Data Requirements
  - Process & Technology
- Internal Controls
  - Initial Risk Assessment
- Transition Option Assessment

Phase 2: Design
- Design processes and controls
  - Refine Systems & Processes, and Data Requirements
  - Select Technology and Manual Solutions
  - Detailed Implementation Plan
  - Revise Processes and Add Internal Controls

Phase 3: Implement
- Develop and test systems and processes
  - Revise Accounting Policies & Model Pro Forma Results
  - Build and Test IT Solutions
  - Improve Systems, Processes, and Controls, as necessary

Go-live & sustain
- Deploy IT Solution, Certify Controls, and Sustain

Assess transition adjustment needs
- Determine information needs based on method selected
  - Calculation of cumulative effect
  - Restatement of 2016 & 2017, including quarters
  - Historical data
  - Population of contracts requiring adjustment

Design transition adjustment approach
- Determine IT and manual solutions, including controls, to ensure completeness and accuracy of data required

Implement: Calculate transition adjustment
- Calculate the transition adjustment and perform tests to ensure accuracy of results

Report and integrate
- Report the transition adjustment and integrate into new systems

Resource Management, Communication and Training

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Revenue implementation - Assess phase progress

Phase 1: Assess - highlights

- A robust assessment is critical to laying the framework for a successful project.
- It’s important to start the assessment early to provide maximum flexibility during the implementation phase.
- Companies that have made significant progress with their implementation observed that the assess phase has taken much longer than they expected.

SEC on internal controls:

- Successful transition to the new revenue standard will depend on the effective design and operation of ICOFR.
- ICOFR remains an important topic of discussion for management, auditors and audit committees.
- Implementation of the new revenue standard will require taking a fresh look at business process level controls.
- Keep in mind the other four components of ICOFR (control environment, risk assessment, information and communication and monitoring activities)
## Transition approaches (time is up)

The following chart summarizes the transition options available to entities *(based on a calendar fiscal year for U.S. public business entities)*

<table>
<thead>
<tr>
<th>Transition approach</th>
<th>2016/2017</th>
<th>2018</th>
<th>Date of cumulative effect adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retrospective</td>
<td>Restate for all contracts</td>
<td>Apply to all contracts</td>
<td>January 1, 2016</td>
</tr>
<tr>
<td>Retrospective Using One or More Practical Expedients</td>
<td>Restate for all contracts except for contracts or estimates covered by the practical expedients elected by the entity</td>
<td>Apply to all contracts</td>
<td>January 1, 2016</td>
</tr>
<tr>
<td>Cumulative Effect at the Date of Adoption</td>
<td>No contracts restated; reported on the basis of legacy guidance</td>
<td>Apply to all new and open contracts or elect to apply to all contracts</td>
<td>January 1, 2018</td>
</tr>
</tbody>
</table>
Cumulative effect transition method

Timeline is based on requirements applicable to a public entity with December 31 year end.

For companies with long-term contracts, the calculation of the cumulative effect adjustment will require historical data to be mined.

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Full retrospective transition method

### 2014 and prior
- Expect most will start this year

### 2015
- Evaluate Existing Contracts for Retrospective Adjustment
- New Systems & Processes

### 2016
- At risk of being too late
- For some companies, contracts are frequently long-term, requiring data mining extending back to earlier years to calculate cumulative effect adjustment.

### 2017
- At risk of having significant issues

### 2018 and beyond
- Existing Systems and Processes for Legacy GAAP Reporting

#### Still time left to:
- Quickly plan, review, decide and document policies
- Educate cross functional teams
- Identify methods to capture required data points for new and existing transactions (systematically or manual upload)
- Process & analyze data in multiple ways to see how the new rules impact your revenue
- Make process and system changes
- Systematically capture required information upstream
- Implement new or upgrade existing systems for Rev. Rec. automation

#### Limited time left to:
- Make some workaround process and system changes
- May not have enough time to implement upstream system process and changes
- May have to start processing new transactions under new guidance and catch up on old transactions over the time
- Disconnected automation or manual processing may be the only option
- Risk of delayed close
- Risk of misstating revenue and costs

#### Situation to avoid:
- Resource constraints both internal and external
- Disconnected automation or manual processing may be the only option
- Risk of delayed close
- Risk of misstating revenue and costs

#### Under retrospective method, new systems and processes should be in place as soon as possible to minimize risk of 2018 and 2019.

### Timeline
- Based on requirements applicable to a public entity with December 31 year end.

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Broad impacts on your organization

For many companies, implementation of the new revenue recognition standard is not just an accounting exercise, as many different groups across the organization need to be involved ...

New Revenue Recognition Standards & Corresponding Accounting Changes
- Impact of new revenue recognition standard and mapping to new accounting rules
- New accounting policies – historical results and transition
- Reporting differences and disclosures
- Tax reporting/planning

Revenue Recognition Automation and ERP Upgrades
- Automation and customization of ERP environment
- Impact on ERP systems
- General ledger, sub-ledgers and reporting packages
- Peripheral revenue systems and interfaces

Financial and Operational Process Changes
- Revenue process allocation and management
- Budget and management reporting
- Communication with financial markets
- Covenant compliance
- Opportunity to rethink business practices
- Coordination with other strategic initiatives

Governance and Change
- Governance organization and changes
- Impact on internal resources
- Project management
- Training (accounting, sales, etc.)
- Revenue change management team
- Multi-national locations
ASC 842 Implementation
Polling Question #3

As it relates to the adoption of ASC 842, where are your Companies’ currently at in the process:

§ We are substantially complete with our assessment
§ We feel good about understanding the impact to our financial statements but we still have a little bit of work to do
§ We have a long way to go
**Now is the time**

<table>
<thead>
<tr>
<th>Effective date</th>
</tr>
</thead>
<tbody>
<tr>
<td>— The new leases standard is effective for public Companies in fiscal year 2019 [For public companies: starting with the first quarter of that year].</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Time-intensive implementation effort</th>
</tr>
</thead>
<tbody>
<tr>
<td>— The new leases standard may require significant effort and time to implement.</td>
</tr>
<tr>
<td>— The leases standard requires data to be gathered and estimates to be made for every lease on a lease-by-lease basis.</td>
</tr>
<tr>
<td>— Additionally, many companies in the implementation phase have found that their existing lease populations were incomplete requiring additional effort and time.</td>
</tr>
<tr>
<td>— If required, new system design and implementation is time consuming and involves many organizational stakeholders.</td>
</tr>
</tbody>
</table>
Effective date and transition

Beginning of earliest period presented
January 1, 2017

Effective Date (date of adoption)
January 1, 2019

SAB 74 Disclosures

Comparative Periods

Current Period

January 1, 2018

Today

December 31, 2019

Modified retrospective transition approach must be used. Early adoption is permitted.
### Effective date and transition, continued

<table>
<thead>
<tr>
<th>Transition approach*</th>
<th>— Apply a modified retrospective transition approach:</th>
</tr>
</thead>
<tbody>
<tr>
<td>*See following slide for additional transition option</td>
<td>- Restate all comparative periods presented</td>
</tr>
<tr>
<td></td>
<td>- No revisions to the accounting for leases that expired prior to date of initial application</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Package of practical expedients (all or nothing)</th>
<th>— An entity may elect not to reassess:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Whether expired or existing contracts contain leases under the new definition of a lease;</td>
</tr>
<tr>
<td></td>
<td>- Lease classification for expired or existing leases; and</td>
</tr>
<tr>
<td></td>
<td>- Whether previously capitalized initial direct costs would qualify for capitalization under ASC 842.</td>
</tr>
</tbody>
</table>

*Does not ‘grandfather’ errors in ASC 840 application*

<table>
<thead>
<tr>
<th>Use of hindsight (elect on its own or with the package of practical expedients)</th>
<th>— Hindsight allowed when considering judgments and estimates such as assessments of lessee options to extend or terminate a lease or purchase the underlying asset</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Does not apply to changes in ‘fact’ – e.g. changes to terms and conditions of the lease or changes in an index or rate used to measure lease payments</td>
</tr>
</tbody>
</table>

| Land easement practical expedient | — Permits a company at transition to not assess whether expired or existing land easements are or contain leases if the company previously did not account for the land easements as leases. |
Additional transition option

FASB will allow companies to use the effective date as their date of initial application

**Topic 842 (as issued):** Date of initial application for a public business entity with a calendar year-end is January 1, 2017

**Practical expedient:** Date of initial application for that same public business entity would be January 1, 2019

- Transition requirements would not change other than delaying the ‘date of initial application’
- No requirement to adjust comparative periods
- Use-of-hindsight would affect effective date accounting only – e.g. change to the lease term from effective date ‘fresh look’ evaluation would result in effective date equity adjustment
- Changes resulting from not electing the package of practical expedients (e.g. write-off of some initial direct costs, changes in lease classification, etc.) would not affect comparative periods presented.
Key implementation challenges

1. The ‘date of initial application’ for many companies is now in the past\(^1\)
2. Identifying the complete population of leases
3. Abstracting key terms to ensure accurate transition accounting
4. Enhanced *lessee and lessor* disclosure requirements that apply to the comparative periods\(^1\)
5. New reassessment and modification provisions will require new processes and controls

\(^1\) Unless the transition practical expedient is utilized
Key implementation challenges (cont’d)

- Is the lease population complete?
  - Contract reviews for potential embedded leases
  - Leases previously not identified as leases

- Resource needs for data abstraction (additional data needed for accounting and new disclosures)?

- Who will make and review lease-by-lease accounting estimates (e.g. residual value, discount rate, reasonably certain assessment, or others)?

- Does the company have systems and/or processes to store data and facilitate Day 2 accounting consequences like reassessment, impairment?
Key implementation challenges (cont’d)

**Balance Sheet Impact**
- Significant increase to total assets
- Significant increase to *current* and *total* liabilities

**Resources/Systems Impact**
- ~3 hours per lease*
- If entity has 2,000 leases
- =
- ~6,000 hours
- or
- ~3 dedicated people for 1 year

* Rough average; experience shows can range from 1-8 hours per lease.
Abstracting lease data

Management must consider what data is needed to prepare the transition adjustment, how captured, and what additional data may be required post-implementation.

<table>
<thead>
<tr>
<th>Lease liability</th>
<th>Right of use asset</th>
<th>Existing capital leases</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Remaining minimum rental payments under ASC 840</td>
<td>• Prepaid or accrued rent</td>
<td>• Carrying amount of capital lease liability and asset</td>
</tr>
<tr>
<td>• Amount probable of being paid under any residual</td>
<td>• Balance of lease incentives/ Straight-line rent</td>
<td>• Unamortized IDCs</td>
</tr>
<tr>
<td>value guarantee</td>
<td>deferral</td>
<td></td>
</tr>
<tr>
<td>• Discount rate at the transition date</td>
<td>• Unamortized IDCs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• ASC 420 liabilities</td>
<td></td>
</tr>
</tbody>
</table>

Data is needed for every lease! Don’t forget about data for disclosures!
Embedded leases

Where could you find embedded leases?

- Advertising...
- Transportation...
- Construction...
- Related party charges...

- 'As a service' contracts
- Sales contracts
- Dedicated manufacturing capacity
- IT services
- Supply contracts

Embedded Leases
What is the challenge with embedded leases?

- There may be embedded leases in existing contracts that were previously not identified
- Many times, the contracts will not use the terms ‘lease’ or ‘rent’ that allow for easier identification
- Contracts may require critical evaluation of whether they create a right to control the use of an asset

Multi-function involvement is key
Leases implementation - phased project plan example

**Phase 1: Assess**
- Initial assessment
  - Scoping and Transition Assessment
  - Accounting Gap Analysis
  - Initial Evaluation of Processes and Systems
  - Prioritize Impacts and Define Workstreams
  - Formalize Steering Committee, Communication Plan and Key Milestones

**Phase 2: Design**
- Impacts assessment
  - Accounting Gaps
    - Accounting Evaluation
    - White Papers
    - Taxes
    - Disclosures
  - Data Requirements, including information needed to calculate any opening adjustment to equity
- Process & Technology
  - Internal Controls Initial Risk Assessment
  - Broader Impact Evaluation:
    - F&A
    - Investor relations
    - Business & Sales
    - HR
    - Legal

**Phase 3: Implement**
- Develop and test systems and processes
  - Revise Accounting Policies & Model Pro Forma Results
  - Build and Test IT Solutions
  - Improve Systems, Processes, and Controls, as necessary

**Transition adjustment activities**
- Implement: Calculate transition adjustment
  - Calculate transition adjustments (including adjustments to comparative periods presented) and perform tests to ensure accuracy of results
- Report and Integrate
  - Report transition adjustments and integrate into new systems

**Resource Management, Communication and Training**
Critical steps toward implementation

Initial assessment

- Scoping and transition assessment
- Accounting gap analysis
- Initial evaluation of processes and systems
- Prioritize impacts and define workstreams
- Formalize steering committee, communication plan and key milestones
Critical steps toward implementation, continued

Impacts assessment

- Contract reviews for lease identification
- Accounting gaps:
  - Accounting evaluation
  - White papers
  - Taxes
  - Disclosures
- Data requirements
- Processes and Technology
- Internal controls initial risk assessment
- Broader impact evaluation - FP&A, Investor Relations, Business & Sales, HR and Legal
Critical steps toward implementation, continued

Design processes and controls

- Refine systems and processes, and data requirements
- Select technology and manual solutions
- Detailed implementation plan
- Revise processes and add internal controls
Critical steps toward implementation, continued

Develop and test systems and processes

- Revise accounting policies and model pro forma results
- Build and test IT solutions
- Improve systems, processes and controls, as necessary
Critical steps toward implementation, continued

Go-live and sustain

- Deploy IT solution
- Certify controls
- Sustain
Critical steps toward implementation, continued

Transition adjustment activities

- Calculate transition adjustment, including adjustments to comparative periods presented
- Perform tests to ensure accuracy of results
- Report transition adjustments
- Integrate into new systems
Stakeholders and involved parties

Core Project Team
- Audit Committee Oversight
- Steering Committee
- PMO
- Multi-location Considerations
  - Accounting and Reporting
  - IT
  - Tax
  - Shared Services
  - SOX Office

Other Internal
- Investor Relations
- Business Operations
- Sales (lessors)
- Legal
- Financial Planning & Analysis
- Internal Audit
- Treasury

External
- Lenders
- Investor Analyst
- External Audit
- Customers
- Regulators
- Industry Peers
### Transition Approach - Lessee

- **Beginning of earliest period presented**: January 1, 2017
- **Effective Date (date of adoption)**: January 1, 2019

#### Comparative Period
- Existing leases entered into before Jan 1, 2017
- Existing leases entered into on/after Jan 1, 2017

#### Current Period
- Operating leases: Apply ASC 840
- Capital leases: Apply ASC 842
- New leases – Apply ASC 842

#### Measurement

##### Operating Lease
- Lease liability = PV of remaining minimum rental payments, amount probable under RVG, using rate at transition date
- ROU asset = lease liability +/- prepaid rent – lease incentives + unamortized IDCs

##### Capital Lease
- Lease liability and ROU asset = carrying amount of capital lease obligation and capital lease asset under ASC 840
- Include unamortized IDCs (not already included in measurement of capital lease asset) in ROU asset
Transition approach - Lessor

Beginning of earliest period presented: January 1, 2017

Effective date (date of adoption): January 1, 2019

Comparative period

December 31, 2018

Current period

December 31, 2019

Existing leases entered into before Jan. 1, 2017

Operating leases:
- No change to measurement of underlying asset
- Measure any lease assets or liabilities (e.g., IDCs, accrued or deferred rent) at carrying amount under current US GAAP
- Account for lease under current US GAAP until effective date

Sales-type and direct financing leases:
- Initially measure net investment in the lease (and its components) at carrying amounts under current US GAAP
- Do not reassess whether selling profit recognized under current US GAAP would be recognized under Topic 842
- Account for lease under current US GAAP until effective date

Expired leases:
- Do nothing

New leases: Apply Topic 842
Next steps

Assessing the impact to your organization is a critical first step.
The following activities may help position you to plan an effective implementation:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>1</strong></td>
<td>Establish project team and governance</td>
</tr>
<tr>
<td><strong>2</strong></td>
<td>Identify other parties beyond accounting and tax that need to be involved</td>
</tr>
<tr>
<td><strong>3</strong></td>
<td>Begin communicating with those charged with governance and internal stakeholders</td>
</tr>
<tr>
<td><strong>4</strong></td>
<td>Build a project plan and timeline</td>
</tr>
<tr>
<td><strong>5</strong></td>
<td>Determine the resources needed</td>
</tr>
<tr>
<td><strong>6</strong></td>
<td>Determine effects on your accounting policies and disclosures</td>
</tr>
</tbody>
</table>
Next steps (continued)

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<table>
<thead>
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<tbody>
<tr>
<td>7</td>
<td>Involve tax resources</td>
</tr>
<tr>
<td>8</td>
<td>Identify new information requirements</td>
</tr>
<tr>
<td>9</td>
<td>Identify system and process gaps</td>
</tr>
<tr>
<td>10</td>
<td>Consider effect on internal controls</td>
</tr>
<tr>
<td>11</td>
<td>Develop initial thoughts on transition approach</td>
</tr>
<tr>
<td>12</td>
<td>Involve your external auditor throughout the process</td>
</tr>
</tbody>
</table>
ASC 715 Implementation
Effective dates and transition

<table>
<thead>
<tr>
<th></th>
<th>Public business entities</th>
<th>All other entities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual periods – Fiscal years beginning after</td>
<td>December 15, 2017</td>
<td>December 15, 2018</td>
</tr>
<tr>
<td>Interim periods – Fiscal years beginning after</td>
<td>December 15, 2017</td>
<td>December 15, 2019</td>
</tr>
<tr>
<td>Early adoption allowed?</td>
<td>Yes, for annual periods for which a company has not issued or made available to issue its interim or annual financial statements. A calendar-year <strong>public business entity</strong> is permitted to adopt as of January 1, 2017 in its Form 10-Q for the first quarter of 2017. A calendar-year <strong>nonpublic entity</strong> could adopt as of January 1, 2016 if it does not issue interim financial statements and has not yet issued (or made available to issue) its 2016 annual financial statements.</td>
<td></td>
</tr>
</tbody>
</table>
Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

**Objective**

To increase transparency for users by simplifying and improving the reporting of net benefit pension cost

**What has changed?**

Disaggregate service cost from other components of net benefit cost.

Present service cost with other employee compensation costs.

Present remaining components separately from service cost and *outside* operating income, if presented.

Capitalize *only* service cost component.
Why change, why now?

**Improved predictive value and transparency**

Financial statement users say net presentation combines elements that are different in their predictive value, which makes analysis difficult and costly. Disaggregation of service cost from other components aims to increase predictive value through improved transparency, and facilitate analysis for financial statement users.
An increasing number of entities have elected to recognize actuarial gains and losses immediately in the income statement. This results in increased volatility in line items that typically include net benefit cost like cost of sales, gross profit, and SG&A. Disaggregation aims to reduce some of this volatility in operating profit.
Implementation issues

The effect that the amendments may have on

- Presentation upon transition to the standard
- ICOFR
- Carrying amount of certain assets
- Contracts tied to operating metrics
Other implementation concerns

- Changes to processes and controls
- Changes to disclosures
- Hybrid transition approach
- Disaggregation of net benefit cost
- Closer alignment with IFRS
- Industry-specific issues
- Capitalization of service costs
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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