



# Avoid potholes

for a smooth ride to peer review



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# Avoid potholes for a smooth ride to peer review

The AICPA analyzes peer review reports to identify **common trouble spots** on the path to a clear peer review. Additionally, the AICPA has an ongoing initiative on **Enhancing Audit Quality** designed to focus firms and peer reviewers on:

- New industries
- Industries with new or rising risks
- Audit areas of increased risk
- Areas with increased inspection matters

This guide will help you pinpoint areas your firm might need to take a closer look at to ensure quality standards are being met. It covers different types of engagements and industries so you can easily navigate based on your practice. This summary is one piece of a toolkit the AICPA is developing to help your firm invigorate its focus on quality. Keep **checking back** for new resources. You can find out more about the topics noted here by reviewing the **Peer Review Areas of Focus** and **Examples of Matters in Peer Reviews** AICPA resource pages.

Use the experiences of others to map your route to a smooth peer review. Don't let these common problems detour your firm from providing quality services at all levels of an engagement.

# Trending issues noted in peer review areas of focus

## By topic:

- Reports
- Representation letters
- Documentation and performance
- Engagement letters
- Disclosures
- Quality control
- Code of Professional Conduct
- Independence

## By specific practice area:

- Not-for-profit organizations
- System and Organization Controls (SOC) reports
- Governmental, A-133 and HUD
- Employee benefit plans
- Broker-dealers
- Issuers of municipal securities
- Banking, including FDICIA
- Crowdfunding and other small business capital-raising (Regulation A)
- PCAOB

# Reports

Audits	<ul style="list-style-type: none"><li>• Not in conformity with <b>clarified auditing standards</b></li><li>• Report date significantly earlier than the date of the review of the workpapers and the release date</li><li>• Failure to appropriately report on supplemental information by:<ul style="list-style-type: none"><li>• Not identifying all supplemental information</li><li>• Using <b>outdated language</b></li></ul></li></ul>
Reviews	<ul style="list-style-type: none"><li>• <b>Not updated for applicable professional standards</b> (i.e., SSARS 21 or SSARS 19)</li><li>• Contained inappropriate titles</li><li>• No mention of responsibility taken on supplementary information</li><li>• Failed to cover all or correct periods in the financial statements</li></ul>
Compilations	<ul style="list-style-type: none"><li>• Not updated for applicable professional standards (i.e., SSARS 21 or SSARS 19)</li><li>• No headings on the report</li><li>• <b>Contained inappropriate titles or lacked titles</b></li><li>• Contained no explanation of the degree of responsibility the accountant is taking with respect to supplementary information</li><li>• Failed to:<ul style="list-style-type: none"><li>• Mention that substantially all disclosures are omitted</li><li>• Refer to the accountant's report on each page of the financial statements</li><li>• Label select disclosures as "selected information substantially all disclosures required by [applicable financial reporting framework] are not included"</li><li>• Cover all or correct periods in the financial statements.</li></ul></li></ul>

# Reports (continued)

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## Agreed-upon procedures

### Failure to include:

- The word “independent” in the report title
- A title
- Reference to the AICPA attestation standards
- A statement that:
  - The sufficiency of the procedures is solely the responsibility of the specified parties
  - Disclaims responsibility for the sufficiency of those procedures
- Identification of the:
  - Subject matter of the engagement
  - Written assertion or the character of the engagement

## Peer review areas of focus

- Entities electing the **accounting alternative** to avoid applying variable interest entity guidance to common control leasing arrangements are not including the required additional disclosures in the footnotes.
- The **Statement of Comprehensive Income** was not presented in a single continuous financial statement or in two separate but consecutive statements but rather as a component of the statement of changes in stockholders' equity.

# Representation letters

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## Audits

### Representation letters that:

- Did not conform with clarified auditing standards requirements
- Were dated incorrectly
- Did not cover all appropriate periods
- Were missing required representations

## Reviews

### Representation letters that:

- Did not include all representations by professional standards require
- Were dated incorrectly
- Did not cover the appropriate periods

# Documentation and performance

Audits	<ul style="list-style-type: none"><li>• Failure to appropriately document <b>planning procedures</b>, including:<ul style="list-style-type: none"><li>• Risk assessment (and linkage of risks to procedures performed)</li><li>• Planning analytics</li><li>• Understanding of IT environment</li><li>• Internal control testing</li></ul></li><li>• <b>Failure to:</b><ul style="list-style-type: none"><li>• Address fraud considerations</li><li>• Communicate and/or document required communications with those charged with governance</li><li>• Address why accounts receivable were not confirmed</li><li>• Document sampling methodology</li><li>• Document consideration of the group audit standard when a component unit was audited by another auditor</li></ul></li><li>• Audit documentation did not contain <b>sufficient competent evidence</b> to support the firm's opinion on the financial statements</li></ul>
Reviews	<ul style="list-style-type: none"><li>• Lacking expectations or the comparison of expectations to actual for analytical procedures</li></ul>
Agreed-upon procedures	<ul style="list-style-type: none"><li>• Lacking sufficient documentation about nature, timing, extent and results of the procedures performed and who performed and reviewed the work</li></ul>

# Documentation and performance (continued)

## Peer review areas of focus

- **Sufficiency of audit evidence – particularly, risk assessment (including linkage to financial statement assertions), internal controls and sampling**
- Peer reviews as well as regulator inspections continue to note **matters** and issues in the area of sufficiency of audit evidence.
- These are most commonly noted among risk assessment and internal controls, where the documentation requirements are very specific, yet involve professional judgment.
  - The documentation should enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing, extent and results of procedures, including significant findings or issues.
- Sufficiency of audit evidence also relates to the quality and quantity of audit evidence where an auditor uses sampling or other audit approaches that do not include testing of all transactions in an account balance or class.
  - The documentation should enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing, extent and results of procedures, including significant findings or issues.
- Entities electing the private company accounting alternative for goodwill that amortized goodwill for more than 10 years (the limit required with this alternative treatment).

# Engagement letters

## Reviews

- Failure to:
  - Obtain an engagement letter
  - Include all required elements in the letter

## Compilations

- **Failure to:**
  - Obtain an engagement letter
  - Include all required elements in the letter
  - Note a lack of independence
- Letter referred to GAAP on an engagement performed in accordance with a special purpose framework

## Agreed-upon procedures

- Failure to include all elements required by attestation standards

# Disclosures

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## FASB accounting standards codification issues

- Missing or insufficient **fair value disclosures** related to:
  - Fair value hierarchy of investments
  - Description of the levels
  - Descriptions of the methods used
  - Tabular presentation of amounts
- Incorrect classifications, gross amounts instead of net and non-cash transactions on the **cash flow statement**
- **Long-term debt** not segregated into current and long-term portions
- Missing or insufficient disclosures for related-party transactions, debt maturation schedules and significant estimates
- Failure to perform sufficient procedures or sufficiently document the procedures to obtain assurance of the fair value measurements
- No disclosure of the date through which **subsequent events** were evaluated

# Quality control (QC)

Relevant ethical requirements	<ul style="list-style-type: none"> <li>• Failure to obtain written confirmation on independence for all personnel</li> </ul>
Acceptance and continuance	<ul style="list-style-type: none"> <li>• <b>Failure to:</b> <ul style="list-style-type: none"> <li>• Obtain a license in all states where engagements were accepted</li> <li>• Evaluate risk of performing an engagement in a specialized industry and/or to obtain the necessary knowledge of current standards in specialized areas prior to performance of the audit</li> </ul> </li> </ul>
Monitoring	<ul style="list-style-type: none"> <li>• <b>Failure to design policies and procedures</b> for the completion of monitoring</li> <li>• Monitoring procedures did not include review of all elements of quality control</li> <li>• Results of monitoring and inspections were not documented</li> </ul>
Engagement performance	<ul style="list-style-type: none"> <li>• Practice aids for performing and documenting engagements were not completed</li> <li>• <b>Criteria for Engagement Quality Control Review (EQCR) not established</b></li> <li>• EQCR not performed on engagements that meet the firm's criteria</li> <li>• Current quality control materials for the performance of engagements not maintained</li> <li>• No established policy for the retention of engagement documentation</li> </ul>
Human resources	<ul style="list-style-type: none"> <li>• Policies not sufficient to ensure partners and staff obtain appropriate CPE</li> <li>• Policies not set to <b>require relevant CPE</b> for levels of service and industries of engagements performed</li> <li>• Current licenses within all jurisdictions the firm practices not maintained</li> </ul>
Leadership responsibilities for quality within the firm	<ul style="list-style-type: none"> <li>• Failure to: <ul style="list-style-type: none"> <li>• Have a written quality control document in accordance with <b>SQCS 8</b></li> <li>• Communicate quality control policies and procedures with staff</li> <li>• Devote sufficient resources for the support of quality control policies and procedures</li> </ul> </li> </ul>

# Code of Professional Conduct

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## Code of Professional Conduct issues

- **Failure to:**

- Establish and document in writing the firm's understanding with the client regarding non-attest services provided
- Address management's responsibilities to oversee and evaluate the results of services performed
- Collect fees for professional services provided more than one year prior to the date of the current report
- Communicate and/or document required communications with those charged with governance

# Independence

## Peer review areas of focus

As it relates to nonattest services provided to audit clients, particularly with respect to evaluation and documentation of the sufficiency of the client's skills, knowledge and experience to oversee the services

- Practitioners must be independent and comply with the requirements of ET sec. 1.295 when providing nonattest services to their attest clients. *(This material focuses on the independence requirements of CPAs when providing nonattest services to clients under AICPA professional standards. Some regulatory bodies, such as the SEC, PCAOB and GAO, have established independence requirements that may be more restrictive regarding the provision of nonattest services for an audit client.)*
- **ET sec. 1.295 Nonattest Services** provides specific guidance to CPAs on the types of nonattest services that impair independence as well as specific safeguards that may be implemented to reduce threats to an acceptable level.
- Notable changes for engagements beginning on or after Dec. 15, 2014:
  - Preparing financial statements, among other commonly performed functions, will constitute nonattest services
  - Multiple nonattest services provided to a client can increase the significance of threats to independence
- One **key safeguard to reduce the threat of management participation** is that the client must designate an individual with suitable skill, knowledge and/or experience to:
  - Assume the management responsibilities
  - Oversee the nonattest service
  - Evaluate the adequacy/results of the services performed
  - Accept responsibility for the results of the services
- CPAs are expected to use their **professional judgment and experience** to determine whether the individual designated by the client can fulfill these responsibilities.

# Trending issues by specific practice area

Matters included in this section are trends or areas of focus for peer reviewers identified for specific practice areas.

# Not-for-profit organizations

Qualifications	<ul style="list-style-type: none"><li>• Necessary knowledge of current standards and obtain the proper training for NFP engagements not obtained</li></ul>
Reporting	<ul style="list-style-type: none"><li>• Auditors' report did not refer to the <b>Statement of Functional Expenses</b></li></ul>
Financial statements	<ul style="list-style-type: none"><li>• Net assets not properly classified as unrestricted, temporarily restricted and permanently restricted</li><li>• <b>Improper expense classifications on the Statement of Functional Expenses</b></li></ul>
Disclosures	<ul style="list-style-type: none"><li>• Inadequate disclosure of the nature, amounts and types of net asset restrictions</li><li>• Policies regarding donated goods and services not disclosed</li></ul>

# System and Organization Controls (SOC) reports

Qualifications	<ul style="list-style-type: none"><li>• SOC 1: <b>Lack of experience and training</b> required under SSAE 16 to properly complete a SOC Report</li></ul>
Reporting	<ul style="list-style-type: none"><li>• Failure to include required elements in the report, such as:<ul style="list-style-type: none"><li>• Management assertions</li><li>• Complementary user entity controls</li><li>• Carve outs</li><li>• Criteria for the principles being opined on</li><li>• Management responsibilities</li><li>• Inclusion of all controls in control activity section</li></ul></li><li>• <b>Failure to update engagement letter for change in the audit guide</b></li></ul>
Documentation and performance	<ul style="list-style-type: none"><li>• SOC 1: <b>The information included in the report did not have sufficient support in the workpapers</b>, such as:<ul style="list-style-type: none"><li>• No documentation to assess the nature, timing and extent of the procedures (specifically sampling methodology)</li><li>• Procedures to test carve outs</li><li>• No documentation of procedures to support the other information included in the report</li><li>• Insufficient documentation of procedures to assess the suitability criteria to evaluate whether management's description of the service organization's system is fairly presented</li></ul></li><li>• <b>Failure to sufficiently test controls</b>, including failure to:<ul style="list-style-type: none"><li>• Address the elements of the control, all IT general controls and change management controls</li><li>• Document which controls at the service organization were necessary to achieve the control objectives stated in management's description of the service organization's system and assess whether those controls were suitable designed to achieve the control objectives</li><li>• Document how sample sizes were selected</li><li>• Coordinate the use of inquiry with other procedures</li><li>• Ensure that the assertions provided by management were sufficient in detail</li></ul></li></ul>

# Governmental, A-133 and HUD

## Reporting

- Failure to include all the **required elements** of professional standards in the **Independent Auditor's Report**, including the following omissions:
  - Reference to the engagement being performed in accordance with *Government Auditing Standards*
  - Identification of the governmental entity's major funds and opinion units presented
  - Addressing supplemental information and required supplemental information
  - Reference to prior year financial statements when comparative years are presented
  - Reference to the Yellow Book Internal Control report
- Failure to include all the **required elements** of professional standards in the **Auditor's Report on Internal Control over Financial Reporting** and on **Compliance and Other Matters**, including:
  - Omitted "Independent" from report title
  - Omitted or incorrect reference to material weaknesses or significant deficiencies included in the Schedule of Findings and Questioned Costs
  - Indication that there were no significant deficiencies identified
  - Omitted a clause stating that the entity's responses were not audited and that the auditor expresses no opinion on those responses
  - Omitted purpose alert
- **Failure to:**
  - Follow the Uniform Reporting Standards and current reporting format for HUD financial statements in accordance with the HUD Consolidated Audit Guide
  - Prepare an engagement letter or issue an agreed-upon procedures report related to REAC submissions
  - Properly and consistently report the results of the single audit between the auditor's reports, the Schedule of Findings and Questioned Costs, and the Data Collection Form, including major program determination and threshold, low-risk auditee status, and evaluation of findings

# Governmental, A-133 and HUD (continued)

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## Disclosure and presentation

- Failure to present the financial statements in accordance with professional standards, including:
  - Fund balance and net position presentation and reconciliations
  - Presentation of funds
  - Missing significant policy footnotes
  - Missing disclosures related to fair value
  - Debt presentation
  - Impairment of fixed assets
  - Financial statement titles
- **Failure to properly implement GASB 65**, properly present deferred inflows and outflows, or modify accountant's report for failure to write off unamortized bond issuance cost
- Failure to use proper terminology required by GASB standards, including net position, classifications of fund balance and deferred inflows/outflows
- Failure to include the REAC financial data templates as supplemental information as required by HUD

## Governmental, A-133 and HUD (continued)

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### Documentation and performance

- **Failure to properly document independence considerations** required by Yellow Book, including:
  - The evaluation of management's skills, knowledge, and experience to effectively oversee nonaudit services performed by the auditor
  - Evaluation of threats
  - Safeguards applied to reduce threats to an acceptable level
- Failure to meet the **Yellow Book CPE requirements** including 80 hours of A&A and 24 hours of Yellow Book specific courses
- Failure to document required communications with those charged with governance including proper communication of internal control findings
- Failure to ensure that the written representations from the audited entity contained all applicable elements, including the following:
  - Representations tailored to the entity and governmental audit regarding federal awards
  - Representations covering both years when comparative financial statements are presented
  - Improper considerations of the date of the representations in relation to the audit report

# Governmental, A-133 and HUD (continued)

<p>Documentation and performance (continued)</p>	<p><b>Single audit issues</b></p> <ul style="list-style-type: none"><li>• Failure to <b>identify and test sufficient and appropriate major programs</b><ul style="list-style-type: none"><li>• Errors were the result of using preliminary expenditures when the final expenditures resulted in a high-risk Type A program, failure to cluster, failure to properly perform Type A and Type B program risk assessments, failure to group programs with the same CFDA number and incorrect determination of the auditee as low-risk resulting in insufficient coverage</li></ul></li><li>• Failure to properly conclude and document either that an applicable compliance requirement does not apply to the particular auditee or that noncompliance with the requirements could not have a direct and material effect on a major program</li><li>• Failure to <b>document an understanding of internal control over compliance of federal awards</b> sufficient to plan the audit to support low assessed level of control risk for major programs<ul style="list-style-type: none"><li>• Includes consideration of risk of material noncompliance (materiality) related to each compliance requirement and major program</li></ul></li><li>• Failure to <b>document the adequacy of the planned sample size</b> for test of controls over compliance to achieve a low level of control risk</li><li>• Failure to <b>document the testing of controls and compliance for the relevant assertions</b> related to each compliance requirement with a direct and material effect for the major program, including insufficient documentation and usage of dual-purpose testing</li><li>• Failure to <b>document internal controls over the preparation of the Schedule of Federal Awards (SEFA)</b></li></ul>
<p>Peer review areas of focus</p>	<ul style="list-style-type: none"><li>• Significant changes will be required by the <b>Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards at 2 CFR 200 (Uniform Guidance for Federal Awards)</b></li><li>• Auditors need to be aware of how the new Uniform Guidance for Federal Awards will affect current and future single audit engagements</li><li>• This includes:<ul style="list-style-type: none"><li>• Planning considerations for Dec. 31, 2015, year-end single audits when the new audit requirements become effective</li><li>• Other considerations for single audits of other fiscal periods ending in 2015</li></ul></li><li>• Most significantly, the new guidance includes changes to the major program determination, applicable compliance requirements, cost principles and auditee administrative requirements</li></ul>

# Employee benefit plan audits – including ERISA and government pensions

Reporting	<ul style="list-style-type: none"><li>• Failure to report significant plan information, such as related party (party in interest) transactions and prohibited transactions between a plan and a party in interest</li><li>• Failure to present a <b>complete schedule of assets (held at end of year)</b></li></ul>
Documentation and performance	<ul style="list-style-type: none"><li>• <b>Insufficient participant testing</b> related to demographic data and payroll</li><li>• Insufficient procedures and documentation for reliance on SOC 1 reports</li><li>• Failure to sufficiently perform procedures related to <b>benefit and claims payment</b> testing, including evaluating participant’s eligibility, examining approvals and recalculation of benefit or claims amounts</li><li>• Failure to obtain an understanding of the actuary’s objectives, scope of work, methods and assumptions, and consistency of application on defined benefit plans</li></ul>
Peer review areas of focus	<ul style="list-style-type: none"><li>• Regulatory and legislative developments have made it clear that there is a significant public interest in, and a higher risk associated with, audits of employee benefit plans.</li><li>• Recent standards promulgated by GASB related to financial accounting and reporting of pensions both at the governmental plan and participating employer levels are extremely complex and will present challenges for auditors.</li></ul>

# Broker-dealers

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## Documentation and performance

- Failure to comply with **SEC Independence Rules**, including not preparing financial statements for clients
- Failure to perform sufficient revenue testing by placing too much reliance on a SOC 1 report
- Failure to make or document the required communications with the audit committee (or board)
- Failure to obtain a **concurring review** as required by PCAOB Standards
- Failure to use practice aids that address PCAOB Standards

# Issuers of municipal securities

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## Reporting

- The Securities and Exchange Commission (SEC) has brought numerous charges related to **municipal securities issuers misleading investors and defrauding investors** in the bond market
- Many of the charges are based on materially misleading statements or improper accounting and/or disclosure for transactions.
- Peer reviewers will be focusing on the financial statement audits of municipal issuers to determine if the **financial statements properly reflect GAAP and that the auditors followed professional standards**. Municipal issuers include:
  - State governments
  - Local governments
  - Certain not-for-profit and for-profit conduit borrowers

# Banking, including FDICIA

Reporting	<ul style="list-style-type: none"> <li>• Failure to include <b>all elements</b> required by professional standards in the accountant's report on internal controls</li> </ul>
Disclosures and presentation	<p><b>Failure to properly disclose:</b></p> <ul style="list-style-type: none"> <li>• Loans by type, delinquencies by type and other segmentation information of the loan portfolio</li> <li>• The policy for recognizing interest income on impaired loans, including how cash receipts are recorded</li> <li>• Valuation allowances, changes in allowances and related segmentation information, and allowance account methodology</li> <li>• Credit quality disclosures related to loans receivable</li> <li>• Consolidated capital ratios and requirements</li> <li>• That the entity was subject to expanded regulatory supervision and why</li> <li>• OREOs and goodwill in the fair value footnote as a non-recurring measurement item</li> <li>• Loan servicing fees, including the amount of contractual fees and assumptions used to estimate the fair value of the fees</li> </ul>
Documentation and performance	<ul style="list-style-type: none"> <li>• Failure to understand and comply with the independence rules applicable to these engagements, i.e., SEC independence rules do not allow the auditor to also prepare the client's financial statements</li> <li>• <b>Insufficient audit testing of real estate lending</b>, including:             <ul style="list-style-type: none"> <li>• Inadequate quantitative information such as aging, past due status or historical charge-offs</li> <li>• Insufficient audit testing of foreclosed property data                 <ul style="list-style-type: none"> <li>- Current year additions</li> <li>- Analysis of fair value/carrying value</li> </ul> </li> </ul> </li> <li>• Insufficient audit testing of:             <ul style="list-style-type: none"> <li>• Certain subjective, qualitative components of the allowance for loan loss</li> <li>• Retrospective review of the allowance for loan loss for bias</li> </ul> </li> <li>• Failure to adequately document <b>testing of member shares and loans receivable</b>, including confirmations and compliance with FASB ASC 310-20</li> </ul>
Management representation letter	<ul style="list-style-type: none"> <li>• Failure to include representations specific to financial institutions</li> </ul>

# Crowdfunding and other small business capital-raising (regulation A+)

## Peer review areas of focus

- The Securities and Exchange Commission (SEC) has issued **final rules adopting regulation crowdfunding and the small business capital-raising rules** known as Regulation A+, effective in 2015
- Regulation A+ offers a simpler way to raise capital through exemptions from SEC's regular registration requirements
- The rules impose many requirements, including the content and reporting framework of financial statements that would be provided to the SEC
- **Crowdfunding allows capital raising at three aggregate offering levels** up to \$1,000,000
- Financial statements filed with the SEC are required to be reviewed or audited depending on the offering level
- A practitioner may not be aware that a client plans to use their report in an SEC filing at the time of engagement, performance of service or when the report is issued
- Exemption from registration for small business issuers based upon two tiers of offerings:
  - Tier 1: Offerings of up to \$20M in a 12-month period
  - Tier 2: Offerings of up to \$50M in a 12-month period
- **Financial statements for Tier 2 issuers must be audited** and are subject to the more restrictive SEC independence requirements, which prohibit the auditor from preparing the financial statements

## PCAOB

## Documentation and performance

- **Failure to perform and report under U.S. GAAS** when an audit is performed under PCAOB standards for a non-SEC issuer not under the PCAOB's jurisdiction

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