

California Board of Accountancy

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The California Board of Accountancy (CBA) licenses, regulates, and disciplines certified public accountants (CPAs) and public accounting firms and corporations. The Board also regulates existing members of an additional classification of licensees called public accountants (PAs). The PA license was granted only during a short period after World War II; the last PA license was issued in 1968. CBA currently regulates over 60,000 individual licensees and 5,000 corporations and partnerships. It establishes and maintains standards of qualification and conduct within the accounting profession, primarily through its power to license. CBA's enabling act, the Accountancy Act, is found at Business and Professions Code section 5000 *et seq.*; its regulations appear in Division 1, Title 16 of the California Code of Regulations (CCR).

CBA is a consumer protection agency located within the Department of Consumer Affairs (DCA). The Board consists of ten members: six CBA licensees (five CPAs and one PA) and four public members. Each Board member serves a four-year term.

The Board's staff administers and processes the nationally standardized Uniform CPA Examination, currently a four-part exam encompassing the subjects of business law and professional responsibilities, auditing, accounting and reporting (taxation, managerial and governmental and not-for-profit organizations), and financial accounting and reporting (business enterprises). Generally, in order to be licensed, applicants must successfully pass all parts of the exam and complete three or four years of qualifying accounting experience; one year of the experience requirement may be waived if an applicant has a college degree.

The operations of the Board are conducted through various advisory committees and, for specific projects, task forces which are sunsetted at project completion. The Board's major advisory committees include the following:

- The Qualifications Committee (QC), authorized in Business and Professions Code section 5023, consists of non-Board member CPAs who review applicants' experience to determine whether it complies with the requirements in Business and Professions Code section 5083 and Board Rule 11.5.

- The Administrative Committee (AC), authorized in Business and Professions Code section 5020, consists of non-Board member CPAs who are authorized to conduct investigations or hearings against licensees, with or without the filing of any complaint, relating to "any matter involving any violation or alleged violation" of the Accountancy Act.

- The Report Quality Monitoring Committee (RQMC), which also consists of non-Board member CPAs, surveys competence in the public practice area. On the basis of a random statistical sampling, the RQMC reviews selected reports on financial statements prepared and issued by licensees; the pur-

pose of the review is to determine compliance with technical accounting principles and established professional accounting standards.

Other advisory committees consist solely of Board members. The Legislative Committee reviews legislation and recommends a position to the Board, reviews proposed statutory and regulatory language developed by other committees before it is presented to the Board, and serves as an arena for various accountant trade associations to air their concerns on issues. The Committee on Professional Conduct considers all issues related to the professional and ethical conduct of CPAs and PAs. The Enforcement Program Oversight Committee was created in 1996 to establish policy and procedures for the Board's complex enforcement program.

MAJOR PROJECTS

Board to Propose Controversial Changes to CPA Licensure Requirements During 2000 Sunset Review

At a joint September 16 meeting, two Board committees whose combined membership includes almost all Board members voted to pursue several major changes to the Accountancy Act during its next sunset review, which is currently scheduled to take place during the fall of 2000. The Board's Sunset Review Committee (SRC) and Uniform Accountancy Act Task Force (UAATF) voted to seek enactment of several provisions of the Uniform Accountancy Act (UAA) which the Board has long hoped to incorporate into California law. The UAA is a model bill and set of regulations drafted by the American Institute of Certified Public Accountants (AICPA), the major national trade association of CPAs, and the National Association of State Boards of Accountancy (NASBA), a coalition of all CPA regulatory boards in the United States.

Specifically, the Board will seek enactment of UAA provisions that would significantly change California law affecting the so-called "three Es" of CPA licensure—education, experience, and examination. In a nutshell, the Board proposes to vastly increase the amount of education necessary for CPA licensure, decrease its existing accounting experience requirement and wholly eliminate the current requirement that applicants for CPA licensure have experience in the "attest" function (the preparation of a certified financial audit), and adopt the UAA's exam passage standards which will make it more difficult for examinees to pass the Uniform CPA exam that is controlled by the AICPA.

The Board sought some of these changes during its first sunset review in 1995–96. However, the Joint Legislative Sunset Review Committee (JLSRC) was not persuaded that the changes were necessary or justified, and instructed the Board

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to conduct a study on its licensure requirements in SB 1077 (Greene) (Chapter 1137, Statutes of 1996). To satisfy that directive, the Board contracted with Dr. Oriel Strickland, a professor of industrial organizational psychology at CSU Sacramento, who conducted a study that utilized a variety of methods aimed at "thoroughly assessing the impact of potential changes to the current education and experience requirements" for CPA licensure. [16:2 CRLR 160-61]

◆ **Education Requirements: Current vs. UAA.** Business and Professions Code section 5081.1 establishes the current educational requirements for CPA licensure. Generally, applicants have three options or "pathways": (a) a bachelor's degree with a major in "accounting or related subjects" requiring a minimum of 45 semester units of instruction in those subjects; (b) completion of a two-year (associate of arts) course of study at an accredited institution, including the study of "accounting and related business administration subjects for a period of four years"; or (c) "the equivalent of the educational qualifications" in (b) above, including completion of ten college-level semester units (or the equivalent) in accounting subjects. In other words, current California law does not require a bachelor's degree for CPA licensure. In contrast, the Board has long supported the UAA's educational requirement of 150 hours of education for CPA licensure—the equivalent of a master's degree—with no "equivalency" loophole allowing those who have not completed formal education to sit for the exam.

However, the report commissioned by the Board does not support its proposal. As noted above, Dr. Oriel Strickland conducted a multifaceted study of the Board's current and proposed education and experience requirements, and released her report, *A Series of Studies Related to the Education and Experience Requirements for Licensure in California*, at the SRC/UAATF's July 16 meeting. To study the education requirement for licensure, Dr. Strickland surveyed the educational background of all examinees at the Board's administration of the May 1998 Uniform CPA Examination. Of import, Dr. Strickland found "no relationship between the number of semester units taken and performance on any of the sections of the CPA examination." In other words, she found no relationship between the number of units taken under the current licensing scheme and passage of the exam; extending this finding to the proposed 150-hour requirement, Dr. Strickland stated: "Thus, there is not strong archival data supporting a requirement of a minimum of 150 semester units to take the CPA examination. The single best predictor of exam performance was the candidate's grade point average."

Dr. Strickland also found that "the average number of semester units taken for this sample was 147.5 (median = 141), suggesting that requiring 150 units prior to licensure might not be a large burden for many candidates....It is important to note, however, the mode (most frequently occur-

ring number) of 120 units, showing that there are a substantial number of candidates who would be affected by an increase. This is most likely to be the case for candidates who have earned bachelor's degrees from a university in the University of California (UC) system." According to Dr. Strickland, UC system schools require an average of 121 semester hours for graduation, and California State University system schools require an average of 127 semester hours for graduation.

Nonetheless, at its joint September 16 meeting, the SRC/UAATF decided to recommend to the full Board that it seek legislative changes requiring 120 hours of education in order to take the exam, and 150 hours of education for CPA licensure. Thus, after achieving 120 hours of education and passing the exam (or while retaking the exam several times and obtaining the required accounting experience), an applicant must take an additional 30 units in order to be licensed. The additional 30 units required for licensure

need not be in accounting, auditing, business administration, or other specified curriculum. Under the Board's current proposal, those units may be in subjects wholly unrelated to the practice of public accountancy.

◆ **Experience Requirements: Current vs. UAA.** Business and Professions Code section 5083 sets forth the accounting experience requirements for CPA licensure. The number of years of experience required is intertwined with the level of education an applicant has achieved under section 5081.1 (see above). If an applicant has a bachelor's degree under section 5081.1(a), he/she must have three years of accounting experience. Under section 5084, if an applicant has graduated from a college with 45 or more semester units in accounting or related business administration subjects and has completed at least 20 units in accounting, only two years of accounting experience is required. To qualify for licensure with less than a bachelor's degree, an applicant must have four years of accounting experience.

Of critical importance, section 5083 requires applicants to have "satisfactory experience in the attest function as it relates to financial statements. For purposes of this subdivision, the attest function includes audit and review of financial statements." The "attest" function is the preparation of a certified audit of a company's financial statements—the only task performed by a CPA which actually requires licensure as a CPA.

In order to qualify toward licensure, all accounting experience must be performed under the supervision of a licensed CPA, and must be performed "in accordance with applicable professional standards." Section 5083 does not describe with particularity the quality or nature of the required accounting experience; instead, it requires the Board to "prescribe rules establishing the character and variety of experience necessary to fulfill the experience requirements set forth

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in this section," including the required attest experience. To implement this requirement, the Board has adopted section 11.5, Title 16 of the CCR. Section 11.5 has been criticized by the Center for Public Interest Law (CPIL), which claims that the section fails to give adequate guidance either to appli-

cants or employers about the nature of the required accounting experience; further, CPIL has repeatedly expressed concern that section 11.5 fails to include the Board's "guideline" that applicants must complete at least 500 hours of attest experience in order to satisfy section 5083. During the Board's 1995-96 sunset review, the JLSRC recommended that the Board revise either section 5083 or section 11.5 to include the 500-hour requirement. [16:2 CRLR 161; 15:4 CRLR 47-50; 13:4 CRLR 6]

In contrast to California's requirements, the UAA requires only one year of accounting experience. Further, the UAA broadens the types of settings in which qualifying experience may be earned. Under the UAA, "this experience may include providing any type of service or advice involving the use of accounting, attest, compilation, management advisory, financial advisory, tax or consulting skills all of which meets requirements prescribed by board regulation." Finally, and most important, the UAA eliminates the attest experience currently required by California law. Thus, newly-licensed CPAs would not be required to demonstrate any experience in the one function for which a CPA license is required—the certified financial audit.

On the general experience issue, Dr. Strickland surveyed 7,500 randomly chosen licensees (about 22% of the licensee population), asking them to indicate the amount of general experience needed to ensure competency under a minimum of supervision. Over two-thirds of the licensees who responded stated that either two or three years of accounting experience is necessary to ensure competency in the areas of accounting, taxation, assurance services, and attest. These licensees also noted a marked improvement in their own skill level after they had between one and three years of experience. Licensees who indicated they have management responsibility tended to feel that two years of experience is needed to ensure competency in accounting and taxation, and three years is necessary for attest and assurance services. Finally, hiring managers tended to value actual work experience more than other precensure factors when evaluating entry-level job applicants.

As to the potential elimination of the attest experience requirement, Dr. Strickland surveyed current licensees/CPAs, li-

censure applicants, and people who identified themselves as hiring managers at CPA firms about the attest experience requirement. According to Dr. Strickland, 70% of current CPAs who responded to the survey stated they believe that the attest experience requirement is "an assurance of entry-level compe-

tence, provides valuable discipline in terms of objectivity and independence, provides critical skills in areas other than attest, and provides a common basis of applying knowledge to a situation." The majority of licensees responding to the survey opposed replacing the attest experience requirement with

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either additional coursework in auditing or more general experience. As might be expected, the majority of licensure applicants found the attest experience requirement burdensome; they complained that there aren't enough firms doing audits to give all of them sufficient experience to meet the licensure requirements. However, Dr. Strickland found that two-thirds of licensees who identified themselves as hiring managers at CPA firms said they could provide audit experience to all or most of their new hires.

Nevertheless, the SRC and UAATF voted in September to recommend that the full Board pursue enactment of the UAA's one-year experience requirement. Despite the proposed elimination of the attest experience requirement, the committees believe that consumers will be adequately protected from CPAs who are not competent to perform audits because (1) one of the four sections on the Uniform CPA Exam tests the attest function; and (2) the UAA provides for the licensure of CPA firms as "attest firms," and only CPAs who are employed by licensed "attest firms" are authorized to perform audits. However, the requirements for licensure as an

attest firm are still under discussion by both the Board and the national organizations (AICPA and NASBA); no state has comprehensively implemented the attest firm provision, and AICPA/NASBA have set forth no uniform standards for attest firm licensure.

At this writing, the Board intends to establish a task force to flesh out this provision of the UAA prior to its sunset review;

preliminary discussions indicate that the Board plans to "grandparent" into "attest firm" licensure all firms that currently perform audits but then require them (as well as all firms licensed as attest firms in the future) to be subject to (1) periodic peer review by Board-affiliated experts or external contractors, to ensure that audits adhere to applicable professional standards, and (2) specialized continuing education requirements focused on auditing skills (which already exist). Required peer review raises many issues, not the least of which

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is cost—both to licensees and to the Board. Peer review is expensive; while large firms that choose to become licensed as “attest firms” can easily afford it, smaller firms and sole practitioners who want to perform attest may not be able to afford it. Further, either the Board would have to establish an in-house peer review unit to review all firms that perform attest (the Board already has a Report Quality Monitoring Committee, which performs random reviews of the workpapers of CPAs who are generally not subject to outside peer review), or it would have to “contract out” that function to an external organization—most likely a professional accounting society. At the committees’ September meeting, DCA legal counsel Bob Miller reminded members that the proposal represents a major change from the way the Board currently does business, and stated that the notion of permitting outsiders to make decisions affecting licensure is dangerous from a legal standpoint.

◆ **Examination Requirements: Current vs. UAA.** All applicants must pass the Uniform CPA Examination, which is drafted, graded, and controlled by the AICPA. All 50 states use this exam, which consists of four parts; each part must be passed. Exam passage rules vary from state to state, and California maintains fairly lenient rules compared to other states which have adopted the UAA’s standards. Under the UAA, a first-time applicant must (1) take all four parts of the exam, (2) pass at least two parts, and (3) flunk the other two parts with a score of at least 50% in order to be granted “conditional credit” for passing the two passed parts. If an applicant has received “conditional credit” for part of the test, the applicant does not have to retake that part again; he/she needs only to retake and pass the flunked parts. California’s rules are more lenient; to receive conditional credit for passing a section of the exam, an applicant simply needs to pass it. The applicant is not required to sit for all four parts and/or obtain a minimum “flunking score” on flunked parts in order to obtain conditional credit for passed parts. However, the SRC/UAATF voted in September to recommend that the Board seek enactment of the UAA’s exam passage standards.

At this writing, Board staff are developing the exact language of a bill to implement the SRC/UAATF’s directives, and seeking input from affected trade associations, consumer groups, and other interested parties. The Board has not yet voted to adopt the SRC/UAATF’s recommendations.

Other Sunset Review Issues

At the end of its 1995–96 sunset review, the JLSRC instructed Board to address several other issues. Over the past year, the SRC and CBA have taken the following actions:

◆ **Ownership and Control of the Uniform CPA Examination.** As noted above, CBA administers the Uniform CPA

Examination, which is owned and controlled by the AICPA. The AICPA is one of the last national trade associations to insist on retaining control over a licensing exam used as a barrier to entry into a profession; most other national trade associations which ever developed and/or controlled a widely-used licensing exam have now divested themselves of such exams due to the obvious conflict of interest when a trade association controls the barrier to entry into its own ranks. Further, the pass rate on the CPA exam is extremely low (most candidates must take the exam three times before passing all four parts), and it has not been validated for occupational relevance since 1991. Following the Board’s 1996 sunset review, the JLSRC recommended that CBA “actively advocate for a national examination developed and administered by a non-trade association.”

CBA Executive Officer Carol Sigmann has taken the lead on this issue. She prepared an exhaustive memorandum analyzing the issues related to AICPA’s ownership and control of the exam for the Board’s January 1999 meeting. According to Sigmann, all AICPA and NASBA committees whose work pertains to the exam are composed solely of AICPA and NASBA representatives, to the exclusion of state board representatives.

AICPA even hires the psychometricians who evaluate the exam, raising questions as to their independence. Administrators who run state boards of accountancy agree that it is their responsibility to select and use an appropriate examination to test the qualifications of candidates who wish to enter into the CPA profession. However, AICPA’s exclusive control over the content and grading of the exam thwarts the ability of state regula-

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tors to ensure that the exam is in fact legally appropriate—subjecting the state boards to potential liability. Barring the complete divestiture of AICPA from exam-related responsibilities, the state boards seek a shift in control over the exam from AICPA to the state boards—either through direct (and preferably majority) state board representation on AICPA committees that control the exam, or through NASBA, the national coalition of state boards of accountancy. Sigmann’s memo analyzed four alternatives to resolving the problem, and concluded that the most feasible option would involve the creation of a not-for-profit entity composed of an AICPA representative, a NASBA representative, and various state board members and administrators, which would administer an examination owned in name by the AICPA but developed, scored, and administered by the entity. At a March 1999 meeting of state board administrators, Sigmann circulated her memo, and subsequently persuaded CBA to forward the memo to AICPA and NASBA leadership as well as all state boards. [16:2 CRLR 159]

In September, DCA adopted new guidelines that may impact this debate. AB 1105 (Jackson) (Chapter 67, Statutes

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of 1999) added section 139 to the Business and Professions Code. Section 139 required DCA to develop, in consultation with the boards, programs, bureaus, and divisions under its jurisdiction, a policy regarding examination development, validation, and occupational analysis. The Department complied with the bill and, on September 30, released guidelines stating that "occupational analyses and/or validations should be conducted every three to seven years, with a recommended standard of five years." As noted, AICPA has not validated the Uniform CPA exam since 1991 (AICPA states that an occupational analysis is currently in progress). In addition, DCA's guidelines set standards for review of national examinations and require DCA boards to "ensure that passing standards for its examination(s) are established, based on minimum competency criteria at an entry level to the profession." Until now, the Board has had to rely on NASBA committees to scrutinize the content and administration of the CPA exam; with section 139, the Board now has some leverage to demand independent access to and evaluation of the exam.

◆ **Continuing Education.** Following the Board's 1996 sunset review, the legislature passed SB 1077 (Greene) (Chapter 1137, Statutes of 1996), which directed CBA to "study and include in its [next sunset] report to the Legislature...the minimum standards for annual continuing education required by the Board." The directive resulted from criticism that CBA's current continuing education (CE) requirement of 40 hours per year (or 80 hours during every biennial licensure period) far exceeds that of any other California occupational licensing board.

To comply with this mandate, CBA staff undertook an extensive two-year study of its CE program, and released a report on its study at the Board's September 1998 meeting. Staff's report stated that "the 80-hour requirement could be significantly reduced without negatively impacting consumer protection." [16:1 CRLR 183] At its November 1998 meeting, however, the Board's Committee on Professional Conduct (CPC) passed a motion recommending that the 80-hour requirement be retained, and that no more than 50% of the required CE hours may be satisfied through courses in basic computer skills, office administration, and/or personal development. At its January 1999 meeting, the full Board approved the CPC's recommendations. The Board is already implementing its decision by proposing to amend its regulations to impose the 50% cap on courses that will not directly enhance competence in public accountancy (see below).

◆ **Enforcement Issues.** CBA will also be required to address several enforcement-related issues left over from its 1995-96 sunset review.

• Following complaints from CPIL, the JLSRC and DCA recommended that the Board's Administrative Committee (AC) be abolished in 1996. Business and Professions Code section 5020 *et seq.* authorizes the Board to create the AC, a 13-member committee made up of non-Board member CPAs who may receive and investigate complaints against CPAs, hold private hearings to obtain information and evidence relating to any

matter involving the conduct of CPAs and PAs, and make recommendations to Board staff regarding disciplinary cases. During the Board's 1995-96 sunset review, CPIL argued that the statute's delegation of broad investigative powers to private parties is improper. CPIL also noted that, for a number of years prior to the Board's sunset review, the AC had been exceeding its statutory authority, in that it was not simply making enforcement *recommendations* (as permitted by Business and Professions Code section 5022)—it was making enforcement *decisions*, including decisions to close cases, forward cases for formal investigation, issue citations and fines, and impose continuing education requirements. Those decisions by the AC were not reviewed or ratified in any way by the Board or its enforcement staff. Board staff and AC members acknowledged as such. CPIL argued that this conduct was unconstitutional as an unlawful delegation of state police power decisionmaking authority to private parties, unlawful as violative of federal and state antitrust law (in that private parties were being permitted to restrain competition, and were not exempt under the "state action" exemption to antitrust scrutiny because the state had neither "clearly articulated" the authority of the AC to make decisions nor was it "actively supervising" the activities of the AC), and unlawful as violative of Business and Professions Code section 5020 (which limits the AC to "making recommendations"). [15:4 CRLR 47-50; 15:1 CRLR 36-38; 13:4 CRLR 5-8]

Although the JLSRC and DCA agreed that the AC should be abolished and that the Board should instead hire more investigative CPAs and delegate to Board staff all investigative responsibilities, the full legislature simply added subsection (c) to section 5020, reminding the AC that it is advisory, and failed to sunset the Committee at that time. Although the AC has apparently complied with the legislature's directive and has scaled back its activities, CPIL is still concerned that the intimate participation of private parties in Board disciplinary investigations will continue to unnecessarily subject the Board to lawsuits like *KPMG Peat Marwick v. Board of Accountancy* (see LITIGATION). In March 1999, the SRC rejected CPIL's concerns, and will recommend to the full Board that the AC be retained in its current format. [16:2 CRLR 161-62]

• In 1995-96, the JLSRC recommended that CBA analyze its "major case program," a separate multi-step disciplinary track it uses to process very high-profile disciplinary cases, "to determine the success (or failures) of the program. The Board should conduct a cost-benefit analysis and a reengineering study, and develop baseline performance measures." The Board says it has merged the major case program into its regular disciplinary program and developed performance measures for its disciplinary system as a whole; it has not performed a cost-benefit analysis of the major case program. Nor has the Board yet reevaluated its controversial use of a Board member as a liaison to the committee that investigates major cases—which results in the automatic recusal of that Board member during subsequent deliberation on case disposition. [16:2 CRLR 163]

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• In 1995–96, the JLSRC also noted that CBA spent only 56% of its budget on enforcement; other major agencies spend 75% or more on enforcement. The JLSRC said “the Board should spend more than 56% of its budget on the enforcement activity, and take a more proactive role in its enforcement program.” Further, the JLSRC stated that CBA should “increase the number of CPA investigative staff and decrease the number of administrative staff under its enforcement program.” The SRC has yet to address these issues in preparation for the Board’s 2000–2001 sunset review.

◆ **Continued Existence of the Qualifications Committee.** In its 1996 sunset report on CBA, the JLSRC recommended that section 5023 of the Business and Professions Code, which authorizes the Board’s Qualifications Committee (QC), should sunset on July 1, 1998. At this writing, the QC still exists within CBA, and it may become unnecessary if the legislature enacts the UAA’s licensure requirements (which include no attest experience). However, if the Board decides to seek licensure of “attest firms,” there may be a role for the QC or a QC-like committee in evaluating the audit experience of the CPAs at attest firms.

◆ **Board Composition.** For many years prior to the Board’s 1995–96 sunset review, the Board consisted of twelve members: eight licensees (seven CPAs and one PA) and four public members. The year before the Board’s first review, the legislature passed SB 2038 (McCorquodale) (Chapter 1273, Statutes of 1994), which reduced the Board’s membership to ten, including five CPAs, one PA, and four public members. [14:4 CRLR 35] During the Board’s 1995–96 sunset review, the JLSRC, DCA, and CPIL all recommended conversion of the Board’s composition to a public member majority. The full legislature did not agree, and left the Board’s composition as reconstructed in 1994.

At its January 1999 meeting, the SRC decided to recommend continuation of the current composition, except that it would prefer to eliminate the reserved PA slot as the PA population is rapidly diminishing. The Committee declined to support a public member majority “because public members lack the expertise to understand technical accounting and auditing issues and may be unwilling to devote the time needed to fully consider the complex cases that come before them.” At its May 14 meeting, the full Board adopted the SRC’s recommendation, and will seek legislation to compose the Board of six “licensees” and four public members.

Questions Regarding “Referral Fees” and the Limits of CPA Licensure

At its July meeting, the Board’s Committee on Professional Conduct (CPC) discussed several issues related to recently-amended Business and Professions Code section 5061, which

now permits a CPA (subject to certain restrictions and detailed disclosure requirements) to accept a commission for referring a client to a third party, and sections 56–56.3, Title 16 of the CCR, the regulations adopted by CBA to implement the new authority in section 5061. The statute specifies that a CPA may only accept a fee or commission for providing a client with the products or services of a third party “where the products or services of a third party are provided in conjunction with professional services provided to the client” by the CPA. In other words, a straight “referral fee” unaccompanied by the performance of “professional services” by the CPA to the client with respect to the third party’s products or services is unlawful. [16:2 CRLR 165; 16:1 CRLR 185, 187–88]

CBA Enforcement Chief Greg Newington explained that the new statute and regulations have generated many questions from licensees, attorneys, and investment firms regarding (1) the point at which a CPA who is advising a client regarding the purchase of securities must be cross-licensed as a securities broker and/or investment adviser; (2) how much activity a CPA must perform to avoid the conclusion that a commission is merely a prohibited “referral fee”; and (3) alternative practice structures through which a CPA might engage in activities for which a commission is permitted, yet also continue to perform audits, reviews, and compilations (where commissions are still prohibited).

The discussion produced as many questions as answers. According to a June 3 “general guidance” letter from the Department of Corporations (which regulates securities brokers/agents and investment advisers under the Corporate Securities Law), a CPA who (for a fee or commission) provides a client

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with products that involve the offer and sale of securities must be licensed as an “agent” or “broker-dealer,” depending upon the precise facts and circumstances, under Corporations Code sections 25003 and 25004. Further, a CPA who (for a fee or commission) provides a client with services that involve the giving of advice with

respect to securities (*i.e.*, investment advisory services) is functioning as an “investment adviser” (especially where separate or additional compensation is received), “investment adviser representative,” or “associated person of an investment adviser,” again depending on the precise facts and circumstances, and should be licensed as such pursuant to Corporations Code section 25009 and 25009.5.

After extensive discussion, the consensus of most Board members was that CPAs who choose to expand their practices to include securities advice and/or purchase are responsible for learning the limits of their CPA license and obtaining other licenses as required, and that the Board’s enforcement program is going to place the burden of proof on the licensee to document that a commission/referral fee received by a CPA for referring a client to a third party was

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accompanied by substantive professional consultation by the CPA to the client concerning the product or service being offered by the third party. For example, if a CPA receives a fee for referring a client to a securities broker, the CPA should provide substantive advice to the client about how that investment fits within the client's overall financial plan. To assist licensees in drawing the line, the CPC decided to fashion a number of hypothetical examples distinguishing lawful commissions from unlawful referral fees and publish them, along with the law on each example, in a future issue of CBA's *Update* licensee newsletter.

CBA Rulemaking on Evidence of Educational Qualifications, Notice of State Licensure, Namestyles

On July 30, the Board published notice of its intent to adopt new sections 9.1 and 50, amend sections 9 and 67, and repeal sections 66, 66.1, and 66.2, Title 16 of the CCR. Following is an explanation of the changes:

• Before being permitted to sit for the Uniform CPA exam, a candidate must present evidence of his/her satisfaction of the educational requirements in Business and Professions Code section 5081.1 to the Board. As discussed above, the educational requirements in section 5081.1 are interwoven with the experience requirements in section 5083. Section 5081.1 permits a candidate to qualify to sit for the exam under any of three "pathways"—subsection (a) is for candidates with a baccalaureate degree with a major in "accounting or related subjects" (including 45 semester units of instruction in these subjects); subsection (b) is for candidates who have successfully completed a two-year course of study, and who can prove that they have "studied accounting and related business administration subjects for a period of at least four years"; and subsection (c) is for candidates who have achieved education equivalent to that required under subsection (b), including a minimum of ten college-level semester units in accounting subjects.

Section 9 specifies the evidence of educational qualifications that a candidate for the examination must provide to the Board. CBA proposes to amend section 9 to update it, make it consistent with 1998 legislative changes to section 5081.1, and state the Board's current educational requirements for examination candidates. Under the proposed amendments to section 9, a candidate seeking to sit for the exam under section 5081.1(a) must "complete 45 semester units or the equivalent including ten semester units of audit and accounting subjects. The remaining 35 semester units may include additional accounting, auditing, or other business related subjects such as: economics, management, finance, business administration, marketing, computer science, law, business communications, mathematics, tax and statistics." To qualify under section 5081.1(b), an applicant must complete 120 se-

mester units or the equivalent, including 45 semester units of accounting and related subjects as described above. To qualify under section 5081.1(c), an applicant must demonstrate completion of foreign education that is equivalent to the education required to qualify under section 5081.1(b), or must pass a Board-approved preliminary written exam and complete ten semester units of audit and accounting subjects.

• AB 2771 (Assembly Consumer Protection Committee) (Chapter 872, Statutes of 1998) amended Business and Professions Code section 5081.1 to clarify the requirements for candidates who have degrees from educational institutions located outside the United States, and permit the Board to require such an applicant to submit his/her documentation of education to a credentials evaluation service approved by the Board. AB 2771 also required the Board to adopt regulations specifying the criteria and procedures for approval of credential evaluation services. [16:1 CRLR 188] As proposed on July 30, section 9.1 sets forth those specific criteria and requirements which must be demonstrated by a credentials evaluation service in order to receive and maintain Board approval.

• SB 2238 (Committee on Business and Professions) (Chapter 879, Statutes of 1998) requires CBA and other DCA occupational licensing boards to adopt regulations requiring their licensees to provide notice to clients that they are licensed by the State of California. [16:1 CRLR 188] Proposed section 50 would implement SB 2238, and require each Board licensee to inform clients that he/she is licensed by the Board

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by any of the following methods: (a) displaying his/her certificate of licensure issued by the Board in the office or the public area of the premises where the licensee provides the licensed service; (b) providing a statement to each client to be signed and dated by the client and retained in that person's

records that states the client understands the person is licensed by the Board; (c) including a statement that the licensee is licensed by the Board either on letterhead or on a contract for services where the notice is placed immediately above the signature line for the client in at least 12-point type; (d) posting a notice in a public area of the premises where the licensee provides the licensed services, in at least 48-point type, that states the named licensee is licensed by the Board; or (e) any other method of written notice, including a written notice that is electronically transmitted, which is reasonably calculated to be received by the licensee's clients.

• In 1998, SB 2239 (Committee on Business and Professions) significantly revised provisions of the Accountancy Act relating to the use of namestyles by Board licensees. [16:1 CRLR 188] In particular, SB 2239 amended Business and Professions Code section 5060 relating to firm names and repealed section 5075 related to partnership registrations. CBA proposes to repeal sections 66, 66.1, and 66.2, several of its former namestyle regulations, and to amend section 67 (regarding use

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of fictitious names) to make it consistent with amended section 5060. As amended, section 67 would state that "no sole proprietor may practice under a name other than the name set forth on his or her permit to practice public accountancy unless such name has been registered with the Board. Any registration issued under this section shall expire five years from the date of issuance unless renewed prior to its expiration."

At its September 17 meeting, the Board held a public hearing on these proposed changes. Following the hearing, CBA adopted all of the changes as published with the exception of new sections 9.1 and 50. The Board made a minor modification to section 9.1 and amended subsection 50(e) to clarify that the posting of a written notice on a licensee's website satisfies the client notification requirement under SB 2238, and adopted both sections as modified. Staff will publish these minor modifications for an additional 15-day comment period, and then submit the rulemaking file for approval by the DCA Director and the Office of Administrative Law (OAL).

Exam Filing Deadlines

On October 1, the Board published notice of its intent to adopt new section 8, Title 16 of the CCR, to establish in regulation the deadlines for filing an application to take the Uniform CPA Exam. In order to allow sufficient time for the Board to review application materials, the Board proposes somewhat earlier filing deadlines for those applying to take the exam for the first time. Under proposed section 8, first-time exam applicants must file their applications to take the May administration of the exam by February 1; those wishing to take the November exam must file their applications by August 1. If the exam filing date falls on a Sunday or national holiday on which the U.S. Postal Service is not open, the filing date will be the next day. The application must be complete, including official transcripts and/or foreign evaluations and the appropriate fees, or it will be rejected by the Board and the applicant will not be scheduled to sit for the exam.

Also under proposed section 8, repeat applicants wishing to retake the exam during the May administration must file their application (with appropriate fees) by March 1; those wishing to take the November exam must file their application by September 1.

At this writing, CBA is scheduled to hold a public hearing on proposed section 8 at its November 19 meeting.

Continuing Education Regulations

On October 1, CBA published notice of its intent to adopt new sections 88.1 and 88.2 and amend sections 87, 87.1, 87.7, 88, and 89, Title 16 of the CCR, its continuing education (CE) regulations which generally require CPAs in public accountancy practice to complete 80 hours of approved CE during each two-year renewal period. According to the Board, the

purpose of the proposed changes is to more clearly specify its CE requirements, increase the internal consistency of the regulations, and make the regulations more consistent with the AICPA's Statement on Standards for Continuing Professional Education Programs.

The Board also seeks to conform its CE regulations to decisions about its CE program that it has recently made in the course of preparing for sunset review. During its 1995-96 sunset review, the JLSRC instructed CBA to reevaluate its 80-hour CE requirement (see above). Although staff recommended that the 80-hour requirement could be substantially reduced without harm to the public [16:1 CRLR 183-84], the Board declined to consider a reduction in the number of hours required for CPAs. Instead, the Board voted at its January 1999 meeting to seek legislation limiting the number of personal development and general computer courses that qualify as CE to 50% of the CE requirement. [16:2 CRLR 160] The substantive changes proposed by the Board are as follows:

- Section 88 describes programs that qualify for CE credit. CBA proposes to amend section 88 to require licensees to complete a minimum of 50% of the required CE hours in subjects "such as the following: accounting, auditing, taxation, consulting, financial planning, professional conduct as defined in section 87.7, computer and information technology (except for word processing), and specialized industry or government practices that focus primarily upon the maintenance and/or enhance-

During its 1995-96 sunset review, the JLSRC instructed CBA to reevaluate its 80-hour CE requirement. Although staff recommended that the 80-hour requirement could be substantially reduced without harm to the public, the Board declined to consider a reduction in the number of hours required for CPAs.

ment of the public accounting skills and knowledge needed to competently practice public accounting." Further, amended section 88 would prohibit licensees from claiming more than 50% of the required number of CE hours in subject areas "such as the following: communication skills, word processing, sales, marketing, motivational techniques, negotiation skills, office management, practice management, and personnel management." Finally amended section 88 would state that "programs in subject areas such as the following are not acceptable CE: personal growth, self-realization, spirituality, personal health and/or fitness, sports and recreation, foreign languages and cultures, and other subjects which will not contribute directly to the professional competence of the licensee."

CBA also proposes to amend section 88 to require licensees fulfilling their CE requirement through "formal correspondence or other individual study programs" to receive a "passing score" in order for the course to qualify as CE. Finally, the Board proposes to amend section 88(d), which permits licensees who teach CE courses to claim CE credit for preparing and teaching those courses, to specify that "for repeat presentations, an instructor shall receive no credit unless the instructor can demonstrate that the program content was substantially changed and that such change required significant additional study or research."

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- Currently, the Board's CE regulations contain no provisions related to the providers of CE courses. Thus, the Board proposes to adopt new section 88.1, to specify requirements for CE providers. For live presentations, subsection 88(a) requires the provider to take attendance and maintain a record of attendance that accurately assigns the appropriate number of contact hours for participants who arrive late or leave early; maintain written educational goals and specific learning objectives, as well as a syllabus, which provides a general outline, instructional objectives, and a summary of topics for the course; and issue a certificate of completion to each licensee upon satisfactory completion of the course. For self-study courses, subsection 88(b) requires the provider to maintain written educational goals and specific learning objectives, as well as a syllabus, which provides a general outline, instructional objectives, and a summary of topics for the course; and issue a certificate of completion to each licensee upon satisfactory completion of the course.

- Currently, the Board's CE regulations contain no provisions related to CE program measurement. New subsection 88.2(a) would require a live presentation CE course to be measured in 50-minute class hours. For programs in which individual segments are less than 50 minutes, the sum of the segments, in increments not less than 25 minutes, may be added together to equal a full class hour. New subsection 88.2(b) would require a self-study CE course to grant CE credit equal to the average completion time if the course is interactive; grant CE credit equal to one-half of the average completion time if the self-study course is non-interactive; and require a passing score on a test given at the conclusion of the course.

- CBA also proposes to amend section 89, which requires licensees to maintain documentation on completed CE courses for four years and, upon license renewal, sign a statement under penalty of perjury certifying that the required number of CE hours has been obtained. Under amended section 89, licensees would be required to disclose the following information concerning courses or programs claimed as qualifying CE: course title or description; date of completion; name of school, firm, or organization providing the course or program; method of study; and number of hours claimed. To receive credit for the eight-hour professional conduct and ethics course required in section 87.7, a licensee must obtain and retain for six years after renewal of his/her license a certificate of completion of such a course disclosing the following information: name of licensee; course title; Board-issued approval number for the course; school, firm, or organization providing the course; and date of completion.

- Section 87.1 addresses the return to an active status license by a licensee whose license had previously been inactive. CBA proposes to clarify section 87.1 to read that a licensee who has renewed his/her license in inactive status may convert to active status prior to the next license expiration date

by (1) completing 80 hours of CE as described in section 88 (see above), including the professional conduct and ethics course described in section 87.7, in the 24-month period prior to converting to active status; (2) applying to the Board in writing to convert to active status; and (3) completing any CE that is required pursuant to section 89(g). The licensee may not practice public accounting until the application for conversion to active status has been approved by the Board.

- The Board's proposed amendments to section 87.7 would add a subsection relating to "secondary providers" of CE courses. Under proposed subsection 87.7(f), an approved CE course provider may allow a secondary provider to present its course through a site license, contractual arrangement, or other type of agreement. Under proposed subsection 87.7(g), for every course presentation (including any made by a secondary provider), the original (primary) approved provider who entered into the approval agreement with the Board must (1) retain for eight years a written outline of the course and completion records to reflect the actual participant attendance, or—in the case of self-study courses—passing test scores of 90% or higher; (2) ensure that all participants who complete the course receive a

Under amended section 89, licensees would be required to disclose the following information concerning courses or programs claimed as qualifying CE: course title or description; date of completion; name of school, firm, or organization providing the course or program; method of study; and number of hours claimed.

certificate of completion (if a secondary provider presented the course, the certificate must identify both the primary and secondary providers); (3) be responsible for the quality and content of the course by requiring and ensuring that the course is presented only by qualified instructors and/or discussion leaders, and that presentations also include all components and content

areas represented in the approval application; and (4) periodically update course content to reflect current laws, regulations, caselaw decisions, and standards of practice.

- The Board's proposed amendments to section 87 are insignificant in nature and would conform section 87 to the above-described amendments to the other CE regulations.

At this writing, the Board is scheduled to hold a public hearing on the proposed amendments to its CE regulations at its November 19 meeting.

Update on Other Board Rulemaking Proceedings

The following is an update on recent CBA rulemaking proceedings described in detail in Volume 16, No. 2 (Summer 1999) of the *California Regulatory Law Reporter*:

- ◆ **Nonlicensee Owners of CPA Corporations.** On July 22, OAL approved CBA's adoption of new section 51 and amendments to section 75.9, Title 16 of the CCR, relating to non-CPA owners of CPA corporations. Enacted in 1997, Business and Professions Code section 5079 permits non-CPAs to be minority owners in public accounting firms, and requires the Board to adopt regulations to implement the requirements of that section. Section 51 requires, at initial registration and

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at renewal, all CPA firms to certify that any nonlicensee owner with his/her principal place of business in California has been informed regarding the rules of professional conduct applicable to accountancy firms. The certification must be signed by a licensed partner or licensed shareholder of the firm. The amendment to section 75.9 requires accountancy corporations with nonlicensee owners to clearly set forth on each share certificate issued to a nonlicensee and in the corporate by-laws of the corporation the conditions and restrictions on nonlicensee ownership specified in section 5079. [16:2 CRLR 165-66; 16:1 CRLR 185-86]

◆ *RQMC's Review of Licensee Financial Statements.*

Also on July 22, OAL approved the Board's amendments to section 89.1, Title 16 of the CCR, which authorizes the Board to request from licensees a statistical sampling and copies of financial reports they have issued. These reports are reviewed by the Board's Report Quality Monitoring Committee as described in section 87.6, Title 16 of the CCR, in order to promote compliance with applicable accounting principles and reporting standards. CBA's amendment to section 89.1 clarifies that the RQMC may require (rather than "request") licensees to supply copies of selected reports on financial statements for review. Such licensees may be selected for participation on the basis of a statistical sampling or upon referral from another committee of the Board. CBA also redefined the term "financial report" in section 89.1 to mean "(1) the licensee's report issued as the result of an engagement covered by generally accepted auditing standards or government auditing standards (audit), or standards for accounting and review services (compilation or review), or attestation standards (attest engagements); (2) accompanying financial statements or other client assertion; (3) accompanying footnotes; and (4) supplementary financial data, if any." [16:2 CRLR 166; 16:1 CRLR 186]

◆ *Citations and Fines.* Also on July 22, OAL approved CBA's amendments to section 95.2, Title 16 of the CCR, which provides a range of fines for various violations of CBA statutes and regulations. The Board revised section 95.2 to update the descriptive names of the listed statutes and regulations, and to add a range of fines for recently added statutes and regulations. [16:2 CRLR 166; 16:1 CRLR 186]

◆ *Use of Mediation in Disciplinary Proceedings.* Following a public hearing at its March 1999 meeting, CBA adopted proposed section 98.1, Title 16 of the CCR, regarding the use of mediation in Board disciplinary proceedings. The proposed regulation would incorporate by reference CBA's *California Board of Accountancy Mediation Guidelines*, previously approved by the Board at its September 1998 meeting. Under the guidelines, mediation is a voluntary process whereby the Board and a licensee of the Board attempt to resolve or narrow issues of dispute with the assistance of a neutral facilitator. A request for mediation should come from the licensee; however, mediation is not a right of the licensee—its use is up to the Board's Executive Officer. The guidelines also set out, among other things, the types of cases appropriate for mediation, types of agreements reached, and the authority and selection of the

mediator. Under the guidelines, mediation sessions must be held in private, and opinions, suggestions, proposals, offers, or admissions obtained or disclosed during the mediation by any party or the mediator must be held in confidence except as authorized by all parties to the mediation or compelled by law. [16:2 CRLR 165; 16:1 CRLR 186-87] At this writing, the rulemaking record on the Board's adoption of section 98.1 is awaiting the approval of the DCA Director and OAL.

LEGISLATION

AB 1677 (Consumer Protection Committee), as amended August 30, changes the Board's name from "State Board of Accountancy" to "California Board of Accountancy," and makes other minor technical changes to the Accountancy Act. The Governor signed AB 1677 on October 6 (Chapter 657, Statutes of 1999).

SB 1306 (Business and Professions Committee), as amended August 31, extends the "sunset" (expiration) date of the Board until July 1, 2002. Governor Davis signed this bill on October 6 (Chapter 656, Statutes of 1999).

AB 1016 (Briggs), as amended in May 1999, would provide that certain protections that apply to a communication between a client and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner before the Employment Development Department, the State Board of Equalization, and the Franchise Tax Board to the extent the communication would be considered a privileged communication if it were between a client and an attorney. This bill failed passage in the Senate Revenue and Taxation Committee on June 17, but was granted reconsideration. [*S. Rev&Tax*]

AB 1190 (Honda), as introduced in February 1999, would also change the Board's name from "State Board of Accountancy" to "California Board of Accountancy." [*A. CPGE&ED*]

LITIGATION

On October 19, KPMG Peat Marwick filed its opening brief in its appeal of Sacramento County Superior Court Judge Lloyd G. Connelly's dismissal of *KPMG Peat Marwick LLP, et al. v. State Board of Accountancy*, No. 98CS03254, in which KPMG which sought to interrupt an ongoing CBA disciplinary proceeding prior to the Board's final decision in the matter because it claimed the Board's investigation was tainted by conflict of interest.

This matter arose after CBA filed an accusation in December 1998 against KPMG over its early 1990s audits of the financial statements of Orange County, which declared bankruptcy on December 6, 1994. The County later sued KPMG for failing to alert it to imprudent investments as part of its audits; the accounting firm eventually settled the lawsuit in June 1998, admitting to no negligence. In its December 1998 accusation, the Board charged KPMG with "unprofessional conduct, including gross negligence, in that the audit work contained extreme departures from applicable professional standards, including the more stringent standards for governmental audits."

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Three days later, KPMG sued the Board, alleging that the investigation upon which the accusation was based was “irremediably tainted by prejudicial procedural irregularities and which cannot provide a proper or lawful basis for any administrative hearing or proceedings against KPMG....” Among other things, KPMG alleged that (1) in the course of its investigation, CBA refused to communicate with KPMG and instead communicated constantly with Orange County and other plaintiffs that had filed civil lawsuits against KPMG, thereby violating several provisions of its own Enforcement Policy Manual (EPM); (2) in communicating with Orange County and its litigation attorneys in connection with the County’s civil action against KPMG, the Board violated its duty to treat as confidential the fact of its investigation, all information received during its investigation, and all documents and records of its licensees which are provided to the Board during the course of its investigation, thereby violating other provisions of the EPM; (3) two members of the Board’s Administrative Committee (AC), which assisted Board staff in the investigation and decisionmaking whether to file charges against KPMG, had actual or apparent conflicts of interest with respect to KPMG; and (4) to represent it in the KPMG disciplinary matter, the Board hired an Ohio-based law firm which also had a conflict of interest, in that it has previously represented KPMG in connection with litigation and a related SEC investigation and obtained “confidential information from and about KPMG....” In its prayer for relief, KPMG asked the court to issue a writ of mandate ordering the Board to discontinue its investigation, withdraw its accusation, and—prior to conducting any further proceedings—“convene a new Administrative Committee hearing panel and conduct a new investigation purged of all procedural irregularities, conflicts of interest, violations of due process, and other indicia of unfairness or irregularity identified by this Court that tainted the State Board’s investigation leading to the issuance of the accusation subject to this action.” [16:1 CRLR 178–82]

In its demurrer, the Board argued that KPMG’s due process arguments are inapplicable to the investigative stage of an administrative proceeding, because no rights are determined during an investigation. Even assuming KPMG’s rights were somehow implicated during the investigation, the Board noted that it has not yet taken (or decided to take) any disciplinary action against KPMG, such that KPMG has failed to exhaust its administrative remedies. Failure to pursue state law administrative remedies, during which a respondent has an opportunity to present evidence to support claims that an accusation is the result of a biased or flawed investigation, is a common bar to the institution of court litigation. CBA also contended that KPMG’s complaint included several “red herring” issues, such as the alleged conflict of interest on the part of AC members; the Board noted that the AC serves in an advisory capacity only and has no decisionmaking authority. Further, CBA argued that KPMG’s reliance on provisions of the EPM is misplaced, because the EPM is not part of the Board’s statute or regulations and confers no legal rights or obligations. As noted, Judge Connelly sustained the Board’s

demurrer and dismissed KPMG’s complaint, based on its failure to exhaust administrative remedies. [16:2 CRLR 166–67]

In its appeal, KPMG argued that the trial court “committed three separate errors, each of which independently requires reversal”: (1) the court dismissed KPMG’s original complaint without giving it leave to amend, and failed to determine that there was no possibility of cure by amendment; (2) the court erred in concluding that KPMG’s mandamus claim was barred by the doctrine of exhaustion of administrative remedies; and (3) the court erred when it ruled that KPMG’s due process claims were subject to the exhaustion doctrine.

KPMG essentially argued that it should have been permitted to amend its complaint to clearly state a cause of action under the Political Reform Act, which prohibits government officials from taking actions that may be affected by their own financial interests, and that such a claim is not subject to the doctrine of exhaustion. KPMG contended that the facts it alleged constitute a violation of the Political Reform Act because the AC members are “public officials” who “made or influenced governmental decisions” when they allegedly had economic interests affected by the KPMG investigation. Further, KPMG contended that any further required exhaustion of its administrative remedies should be excused because it would have been futile—KPMG repeatedly attempted to bring the alleged conflicts to the attention of the Attorney General’s Office, but was rebuffed. KPMG also contended that, under federal caselaw, the exhaustion doctrine is not applicable to its due process claims against the Board.

At this writing, the Attorney General’s Office has yet to file a responsive pleading to KPMG’s appeal.

RECENT MEETINGS

At its May 14 meeting, the full Board adopted portions of a July 6, 1995 disciplinary decision as a “precedential decision” pursuant to Government Code section 11425.60, a relatively recent addition to the Administrative Procedure Act that permits an agency to formally designate decisions that it intends to rely upon as precedent. In the decision (No. AC-94-2), the Board revoked the license of San Diego CPA Daryl Drummond because he had been convicted in federal court on two felony counts of filing false personal income tax returns. The portions of the decision designated as precedential state that a conviction of the crime of filing personal income tax return is substantially related to the qualifications, functions, and duties of an accountant (and is thus grounds for disciplinary action).

FUTURE MEETINGS

- November 18–19, 1999 in San Francisco.
- January 20–21, 2000 in Los Angeles.
- March 24–25, 2000 in San Francisco.
- May 18–19, 2000 in Riverside.
- July 20–21, 2000 in San Diego.
- September 21–22, 2000 in San Francisco.
- November 16–17, 2000 in Los Angeles.