

## Board of Accountancy

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The Board of Accountancy (BOA) 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. BOA 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. BOA'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).

BOA is a consumer protection agency located within the Department of Consumer Affairs (DCA). The Board consists of ten members: six BOA 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 purpose 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's Sunset Review Postponed Until Fall of 2000**

During the spring of 1999, the Board learned that its "sunset review" by the Joint Legislative Sunset Review Committee (JLSRC) and the new Davis administration has been postponed until the fall of 2000. Currently operating under a sunset (expiration) date of July 1, 2001, the Board had been preparing for a review during the fall of 1999, such that legislation extending the Board's existence beyond July 1, 2001 could be passed during 2000. [16:1

CRLR 182-84] To accommodate the new review date, the Senate Business and Professions Committee is carrying legislation extending the Board's existence until July 1, 2002 (see LEGISLATION). Under the new schedule, the Board will be reviewed during November 2000, and legislation extending its existence and potentially making other changes in the Accountancy Act may be introduced and enacted during 2001.

Coordinating the Board's overall approach to its 2000-01 sunset review is the Sunset Review Committee (SRC), chaired by public member and current Board vice-president Baxter Rice. Providing input to the SRC is the Uniform Accountancy Act Task Force (UAATF), a Board committee that is analyzing provisions of the Uniform Accountancy Act (UAA) which the Board has long hoped to incorporate into

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California law. The UAA is a model bill and set of regulations drafted by the American Institute of Certified Public Accountants (AICPA) and the National Association of State Boards of Accountancy (NASBA), and is intended to provide a uniform approach toward regulating the accounting profession.

Several issues raised during the Board's initial 1995-96 sunset review have been targeted by the JLSRC for Board consideration and resolution in the interim period prior to its next review. These issues include the following:

♦ **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 the Center for Public Interest Law 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 25 meeting, the SRC discussed a variety of composition options, and 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 this writing, the full Board is expected to act on the SRC's recommendation on Board composition at its May meeting.

♦ **Ownership and Control of the Uniform CPA Examination.** Along with every other state and four territories, BOA administers the Uniform CPA Examination, which is owned and controlled by the AICPA, the largest national trade association of CPAs. Following the Board's 1996 sunset review (during which it was noted that the pass rate on this exam is extremely low; see RECENT MEETINGS), the JLSRC recommended that BOA "actively advocate for a national examination developed and administered by a non-trade association." Throughout the latter half of 1998, the Board discussed plans to persuade AICPA to transfer ownership and control of the licensing exam to NASBA or some other non-trade association. At its November meeting, the Board tentatively approved a resolution authorizing NASBA—in negotiations with AICPA—to represent that BOA approves the transfer of ownership and administration of the licensing exam to NASBA. However, upon further discussion, the Board re-

quested staff to return at its January 1999 meeting with further analysis, objectives, options, recommendations, and a draft letter regarding control of the examination. [16:1 CRLR 182-83]

At BOA's January 26 meeting, Executive Officer Carol Sigmann presented an extensive analysis of the issues related to AICPA's ownership and administration of the Uniform CPA Examination. Sigmann noted that "the foundational reason for advocating a change in the AICPA's ownership is because of a perceived conflict of interest posed by a professional association's owning and controlling the examination instrument used as a barrier to entry into the profession. The appearance of a conflict arises because the Board's regulatory

mission is consumer protection, while the association's mission must necessarily be advocacy for and protection of members." Sigmann also stated that "the concern about the AICPA's ownership of the exam is further underscored because the Institute owns every facet of the exam, including the

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development of the questions and form of the examination, as well as its administration and grading." According to Sigmann, administrators who run state boards of accountancy agree that, although 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, the AICPA has made many changes to the exam—including its recent decision to computerize the exam—without seeking input from state boards. Essentially, the state boards seek a shift in control over the exam from AICPA to the state boards.

Sigmann's memorandum explored the various entities within AICPA and NASBA responsible for some aspect of the examination process, and their complex interrelationships. She noted that "none of the members who sit on AICPA's Board of Examiners or NASBA's Examination Review Board are trained psychometricians, and they do not possess the skills to evaluate psychometric studies or occupational (practice) analyses—the key elements which validate an examination." Sigmann observed that critics consistently question whether the same organization that develops and scores an exam should also be responsible for validating it, whether psychometricians hired by AICPA can be deemed independent of the trade association, and how pass points are set (and by what entity). Recognizing that NASBA has recently created an "Examination Committee" and charged it with "determining the will" of its member state boards regarding the construction, grading, administration, cost, format, and vendors of licensing examinations, Sigmann noted that this effort will take time and the cooperation of all states.

Sigmann presented four alternatives for Board consideration: (1) maintain the status quo; (2) NASBA should assume the ownership of the exam and the responsibilities of developing, scoring, and validating it; (3) form a "hybrid"

not-for-profit entity composed of an AICPA representative, a NASBA representative, as well as various state board members and administrators, to administer an examination owned in name by the AICPA but developed, scored, and administered by the entity; or (4) form an entity composed of board members and administrators to assume ownership of the examination and issue a request for proposals from all testing vendors for the development, preparation, and grading of a CPA licensing examination.

Although option (2) above has been considered in the past [16:1 CRLR 182-83], Sigmann questioned whether the NASBA entities which currently have some role in the examination process are truly independent of AICPA, noting that many of the CPAs who sit on NASBA's Examination Review Board have current or former service ties with AICPA's committees and subcommittees; according to Sigmann, "it may be difficult to see where one organization ends and the other begins." Sigmann recommended option (3) above as "the most feasible option in initiating a transition from sole AICPA ownership and control of the exam to a new entity that appropriately has controlling responsibility for the critical components of the examination process."

The Board's Committee on Professional Conduct (CPC) reviewed Sigmann's memo and recommendations at its January 25 meeting. DCA legal counsel Bob Miller observed that one of the main weaknesses of the Uniform CPA Exam is that it is not known if the exam is statistically valid. AICPA's scheduled occupational analysis of the exam is overdue and, if the exam were challenged, the Board would bear the burden of demonstrating its validity. However, the CPC declined to approve Sigmann's recommendation, and instead decided to recommend that the full Board simply authorize Sigmann to share her memorandum with other state boards at an upcoming NASBA Administrators' Conference. Additionally, the CPC approved the notion of selecting its own psychometrician to actively participate in the upcoming occupational analysis and validation of AICPA's exam. At its January 26 meeting, the full Board concurred with the CPC's recommendations, and identified Dr. Norman Hertz, a psychometrician with DCA's Office of Examination Resources, as its preferred expert to participate in the upcoming validation.

At the CPC's March 19 meeting, Sigmann reported on her attendance at the NASBA Administrators' Conference. The CPC decided to recommend to the full Board that Sigmann send her analysis to NASBA, with a copy to the leadership of the AICPA and to all state boards of accountancy, communicating the Board's support for shifting responsibility for policy-setting and decisionmaking regarding the exam from the AICPA to the state boards. At its March 20 meeting, the full Board approved the CPC's recommendation, but directed staff to add a cover letter noting that the

Board believes the exam should remain a uniform national examination, that efforts to computerize the exam should continue, and that NASBA should be encouraged to provide programs at its regional and national meetings to educate state boards regarding their responsibilities as to the exam.

♦ *Review of Existing Continuing Education Requirements.* Following the Board's 1996 sunset review, the legislature passed SB 1077 (Greene) (Chapter 1137, Statutes of 1996), which directed BOA 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 BOA'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, BOA 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. At its November 1998 meeting, the CPC passed a motion recommending that the 80-hour requirement be retained, but 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. The CPC also approved a number of other recommendations related to the CE requirement. [16:1 CRLR 183-84]

At its January 26 meeting, the full Board approved the CPC's recommendations. Thus, BOA will recommend to the JLSRC that the current 80-hour biennial CE requirement be retained but amended to include a 50% cap on personal development and general computer courses. BOA will also recommend that a relatively new requirement under AB 1260 (Machado) (Chapter 639, Statutes of 1996) be continued. AB 1260 (Machado) amended Business and Professions Code section

5027 to require CPAs who provide audit, review, or other attestation services, or who compile financial statement reports, to complete a minimum of 24 hours of CE in the area of accounting and auditing related to reporting on financial statements. Although AB 1260 became effective on January 1, 1997, the Board did not enforce it until July 1, 1998, giving itself time to amend section 87, Title 16 of the CCR, and its licensees time to adjust to the new requirement. According to staff's CE study, the Board's Report Quality Monitoring Program has found that the financial statement reports of licensees who fail to take any auditing or accounting CE units are somewhat more likely to be found marginal or substandard. At a future time, the Board may revisit this recommendation as to licensees who perform only compilations.

♦ *Education and Experience Requirements.* SB 1077 (Greene) also directed BOA to study "(a) the minimum standards for passage of the Board's licensing examination; (b) the relevance of the licensing examination to the practice of

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accountancy; and (c) the experience requirement to obtain a license from the Board." This mandate resulted from: (1) the Board's desire to implement the so-called "150-hour requirement" of the UAA, under which an applicant for a CPA license must have the equivalent of a master's degree before being licensed (see below), and (2) comments by the Center for Public Interest Law during BOA's 1995-96 sunset review that the Board's experience requirement, particularly the 500-hour "guideline" for required precensure attest experience, is not adequately articulated in statute or regulation.

As set forth in Business and Professions Code sections 5081.1 and 5083, the Board's education and experience requirements are currently intertwined and very complex. Generally, if an applicant has a baccalaureate degree from an approved four-year institution with 45 semester units in business-related subjects (including at least ten units in auditing/accounting subjects), the Board requires three years of accounting experience (or two years of accounting experience if the applicant has completed at least 20 units in auditing/accounting subjects). If an applicant has a college-equivalent degree from an institution outside the United States, with 45 semester units in business-related subjects and including at least ten units in auditing/accounting subjects, the applicant must have three years of accounting experience (or two years of accounting experience if the applicant has completed at least 20 units in auditing/accounting subjects). If an applicant has no degree, but has completed at least 120 semester units with 45 semester units in business-related subjects (including at least ten units in auditing/accounting subjects), the applicant must have four years of accounting experience. If an applicant has no degree but has completed at least ten semester units in auditing/accounting subjects and has passed the CLEP examination, the applicant must have four years of accounting experience.

Currently, "accounting experience" must be gained under the supervision of a person licensed to practice public accountancy, must be performed in accordance with applicable professional standards, and must include experience in the attest function. Under section 5083, the Board is required to adopt regulations establishing the "character and variety of experience necessary to fulfill the experience requirement set forth in this section, including a requirement that each applicant demonstrate to the Board 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 Board

has adopted section 11.5, Title 16 of the CCR, to implement section 5083. However, Rule 11.5 fails to state the number of hours of attest experience required for licensure. Instead, the Board has included in the instructions on its "Form E," the form which employers/supervisors of CPA licensure applicants are required to complete, the following statement: "Although no minimum number of hours has been prescribed for certification, as a guideline, it is doubtful that an individual can obtain the [required attest] experience in less than 500 hours." For over seven years, the Center for Public Interest Law has expressed concern about the Board's failure to codify its "guideline" in either its statute or regulations. [15:4 CRLR 47-50; 13:4 CRLR 6; 12:1 CRLR 40-41] During the Board's 1995-96 sunset review, the JLSRC recommended that section 5083 be amended to include the 500-hour requirement.

To comply with the requirements in SB 1077, the Board has contracted with Oriel Strickland, Ph.D., professor of industrial organizational psychology at CSU Sacramento. Dr. Strickland is conducting a study of the educational qualifications and other background characteristics of examinees who took the May 1998 Uniform CPA Exam, and a number of other studies and surveys of both licensees and licensure candidates in an attempt to determine the appropriate educational and experiential level required for CPA licensure. She will attempt to determine the propriety of both the

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Board's current education requirement and the proposed 150-hour requirement under the UAA (see below). At this writing, Dr. Strickland is expected to present the results of her studies at the SRC's July meeting.

As to codifying its 500-hour attest experience "guideline" for purposes of licensure, the Board appears content to do nothing in hopes that the legislature will enact the UAA's experience requirements for licensure. The UAA requires no attest experience for licensure (see below).

◆ *Continued Existence of the Administrative Committee.* Business and Professions Code section 5020 *et seq.* authorizes the Board to create the Administrative Committee (AC), a 13-member committee made up of non-Board member CPAs who may receive

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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, the Center for Public Interest Law (CPIL) expressed serious reservations about the structure and role of the AC. CPIL's fundamental concern

focused on the fact that the AC consists of private parties—private practitioner CPAs delegated broad powers by statute to participate intimately in the Board’s disciplinary process by investigating complaints and even compelling and presiding over investigative hearings against colleague or competitor licensees. 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]

CPIL urged the Board to sponsor legislation abolishing the AC, and replace it with a panel of subject matter experts who can assist the Board’s enforcement program on a case-by-case basis, subject to strong confidentiality agreements and conflict-of-interest restrictions. Instead of financing the AC, CPIL urged BOA to supplement its staff of Investigative CPAs and require all complaint investigation to be handled by professional CPA investigators employed by the Board, assisted by subject matter experts from the panel where needed. Although both the JLSRC and DCA agreed with CPIL that the AC should be abolished, the full legislature added subsection (c) to section 5020, reminding the AC that it is advisory, and failed to sunset the Committee at that time.

At its March 18 meeting, the SRC took up the issue of the continued need for the AC. The Committee considered a letter from CPIL’s Julie D’Angelo Fellmeth, who again urged BOA to abolish the AC in favor of a panel of experts who can assist the Board’s enforcement program with expert file review in complex cases and expert testimony at adjudicative hearings on a case-by-case basis. CPIL reiterated its concern that the AC is composed of private parties who are influential in disciplinary matters in which they know the identity of the accused licensee. To consumers, the AC appears to be a “screen” set up by the profession for the profession through which all serious disciplinary matters must pass; to licensees, the AC structure arguably presents an opportunity for private parties improperly seeking to harm competitors (see LITIGATION). CPIL argued that the legislature’s 1996 amendment to section 5020 is inadequate: “Although there is

nothing wrong with the Board’s use of private party subject matter experts in individual cases (who are subject to strong confidentiality agreements and conflict-of-interest restrictions), CPIL is uncomfortable with the rigid AC structure through which all technical cases in which staff have found a probable violation must pass.” CPIL again urged the Board to enlarge its full-time investigative staff and delegate to that staff responsibility for handling all complaint investigations.

The SRC rejected CPIL’s comments. The Committee noted that since the Board’s 1995–96 sunset review, the size of the AC has been reduced, the AC has complied with the legislative directive that it function on a purely advisory basis, most of the AC’s subcommittees have been eliminated, and some of the AC’s former responsibilities have been transferred to staff. Further, the Board’s new Enforcement Program Oversight Committee (EPOC) has established performance measures for the enforcement program, and there has been substantial improvement in some areas. The SRC determined that “the expertise provided by the AC members is not available from any other source at a reasonable cost or expenditure,” and that if the AC were to be replaced with outside experts with comparable expertise, the enforcement process would become even more expensive and time-consuming. The SRC adopted the AC’s recommendation that it continue to exist, with some modifications: (1) the AC’s Major Case Task Force will be eliminated in favor of using separately formed panels of the AC to hold investigative hearings in major cases; (2) the monitoring of probationers should be transferred to staff; and (3) the AC should discontinue its file review of closed cases involving unlicensed activity.

At this writing, the full Board has not yet acted upon the SRC’s recommendation.

♦ **Major Case Program.** The Major Case Program has long been part of the Board’s two-tiered investigative process—one for “regular” cases and one for high-profile (or “major”) cases. Potential major cases may be identified through various sources such as the news media and referrals from other regulatory agencies. Cases may be referred to the Major Case Program—a three-stage, 14-step process guided by a “Major Case Advisory Committee”—by Board members, AC members, Board staff, other affiliates of BOA, or other individuals or agencies. The program handles approximately 10 cases each year. [14:4 CRLR 32-34]

Following BOA’s 1995–96 sunset review, DCA recommended that the Board eliminate the major case program as a “separate program”; the JLSRC recommended that the Board perform a cost-benefit analysis of the program’s effectiveness. Since that time, the Board has merged the Major Case Program into its Enforcement Program such that it technically is no longer a “separate program.” However, the Board’s procedures related to major case management are still distinct from those used in other cases (see below, regarding the use of a Board member liaison to staff’s investigation of major cases), and the Board has not yet performed a cost-benefit analysis of the Program as recommended by the JLSRC.

◆ *Other Enforcement Issues.* At its March 19 meeting, the SRC considered a number of other enforcement-related issues. First, the Committee discussed an issue fairly unique to the Board of Accountancy—its use of a Board member as a “liaison” to the investigation and prosecution of “major cases” (see above). BOA’s insistence on utilizing a Board member to monitor staff’s investigation of a major case—and its consequent loss of that Board member as a decisionmaker in the matter—has prompted warnings by CPIL and others. Several Board members, including public member Baxter Rice and PA member Walter Finch, have repeatedly urged the Board to abandon the practice. Although Rice and Finch reiterated their positions at the March meeting, their objections were overruled. However, the Committee could reach no consensus on the issue; a motion to continue the current practice died for lack of a second, as did a motion to eliminate the Board liaison in major cases. The SRC decided to revisit the matter at a future meeting.

The SRC also noted that EPOC members have been reviewing closed investigative cases in closed session. This practice, undertaken in order to determine whether staff is adhering to the Board’s enforcement policies, was criticized by CPIL at the Board’s May and July 1998 meetings because, again, it exposes Board members (who are required to be ultimate decisionmakers in Board disciplinary proceedings) to unredacted casefiles which may be resurrected in future enforcement proceedings. The SRC agreed that “the benefits outweigh the risks,” and voted to continue the practice.

The SRC then discussed whether the Board should expand its use of the restitution remedy authorized by Government Code section 11519, as recommended by the JLSRC during the Board’s 1995–96 sunset review. Staff noted that BOA has somewhat increased its requests for restitution, but expressed reluctance to further expand its use of the remedy. According to staff, restitution is usually a condition of probation—meaning the licensee keeps the license. However, license revocation is the only appropriate remedy for some offenses, and license revocation generally precludes the licensee from earning sufficient money to make restitution. The SRC agreed to recommend continuation of the Board’s current policy in this area.

◆ *Continued Existence of the Qualifications Committee.* In its 1996 sunset report on BOA, the JLSRC recommended that section 5023 of the Business and Professions Code, which authorizes the Board’s Qualifications Commit-

tee (QC), should sunset on July 1, 1998. At this writing, the QC still exists within BOA, and it may become unnecessary if the legislature enacts the UAA’s licensure requirements (which include no attest experience). At this writing, continuation of the QC is slated for discussion at the SRC’s May 1999 meeting.

In addition to issues which the JLSRC will undoubtedly raise, the UAATF hopes to use the sunset review process as an opportunity to educate the legislature about the UAA, and to promote the introduc-

tion of the UAA’s requirements which are not yet part of California law. These issues include the following:

◆ *UAA’s “150-Hour” Education Requirement.* As noted above, the Board’s UAA Task Force is hoping to gain consensus on the enactment of the UAA’s provisions in three “E” areas: education, experience, and examination. In the education area, the UAA requires 150 semester units from an accredited four-year university, with 45 semester units of instruction in accounting or related subjects. As noted above, California law does not even require a bachelor’s degree; further, experience may substitute for education for purposes of entrance to the CPA exam and licensure. However, approximately 45 states have enacted the 150-hour requirement, and pressure is apparently mounting on the California

Board to conform. BOA has been attempting to incorporate this requirement into California law for almost a decade; the work of the Board’s 1989–90 “150-Hour Education Task Force” resulted in the introduction of SB 869 (Boatwright), a 1992 bill which would have phased in the 150-hour requirement by 1997, but which was not passed by the legislature. [12:4 CRLR 51; 10:4 CRLR 50]

The Board hopes that empirical support for the proposed 150-hour requirement will emerge from the education study currently being undertaken by CSU Sacramento’s Dr. Oriel Strickland (see above).

◆ *The UAA’s Experience Requirement.* For purposes of initial licensure, the UAA requires applicants to complete only one year of experience in government, industry, academic, or public practice; the experience may be any type of service or advice involving the use of accounting, attest, management advisory, financial advisory, tax, or consulting skills, all of which must be verified by a licensed CPA and meet board-approved requirements. No attest experience is required for CPA licensure under the UAA. If a licensee subsequently wants to engage in the attest function, the UAA requires that he/she operate in a licensed firm which

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undergoes peer review every three years, and meets other professional experience requirements which have yet to be developed and implemented.

As noted above, Business and Professions Code section 5083 currently requires at least three years of experience (of which one year may be satisfied by attainment of a relevant college degree under section 5084) prior to California licensure, and requires licensure candidates to "demonstrate to the Board 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 UAA's reduction of the overall experience requirement and its elimination of the attest experience requirement are controversial issues. During the Board's 1995-96 sunset review, CPIL's Julie D'Angelo Fellmeth opined that the attest function is "the essence of the CPA license. It is the only function reserved to the CPA profession. Consumers have no choice as to practitioner when an audit is needed; a CPA must be used." She noted the findings of the Board's own Report Quality Monitoring Committee that, even with the existing audit experience requirement, an unacceptable proportion of the audits reviewed (one-fourth to one-third) are marginal or substandard: "Doing away with the attest experience requirement would further diminish CPAs' competence in the attest function." [15:4 CRLR 47-50] Even some accountant trade associations appear unwilling to move to one year of experience, and may accept two years only if applicants are required to complete 150 hours of education (a master's degree equivalent), or if they are prohibited from engaging in audit/attest work. This topic will be the subject of many Board and committee discussions prior to the Board's sunset review.

♦ **Examination Issues.** In addition to the ownership and validation of the Uniform CPA Examination (see above), BOA plans to explore another issue related to the licensing examination. The Board has discussed adhering to the UAA's exam passage standard, which requires that a candidate take all parts of the exam, pass at least two parts, and achieve a minimum failing score of 50 on the remaining parts in order to be granted "conditional credit" for the two parts passed (*i.e.*, the candidate need not retake the passed parts). Under the more lenient BOA policy, conditional credit is granted to a candidate who receives a passing grade in two or more sections in a single examination sitting. Candidates are not required to take all parts of the exam in order to receive conditional credit for two passed sections; in fact, they may elect to take only two sections of the exam.

## **Board Disclosure of Disciplinary Actions and Citations/Fines**

At its November 1998 meeting, the Board finally ended a long stalemate among several of its committees by voting

to voluntarily disclose citation and fine actions to inquiring members of the public, so long as the caller is also informed of the precise reason for the citation and/or fine. The Board also deferred implementation of its new policy pending review by staff and the Enforcement Program Oversight Committee. [16:1 CRLR 187]

At its February 22 meeting, the EPOC considered the precise implementation of the new policy, as well as a July 1998 recommendation by the Administrative Committee that the Board limit disclosure of citations/fines for a period of five years after their issuance. The discussion was expanded to include formal disciplinary actions, as well as citations/fines. Deputy Attorney General Mike Granen advised that although the Board is not authorized to remove either disciplinary actions or citations/fines from a

**Deputy Attorney General Mike Granen advised that although the Board is not authorized to remove either disciplinary actions or citations/fines from a licensee's record, no law requires the Board to volunteer that information.**

licensee's record, no law requires the Board to volunteer that information. Granen noted that the action codes identifying disciplinary actions and citations/fines could be removed from the Board's computer screens after a certain period of time, such that staff receptionists fielding calls from members of the public would not be able to volunteer information about certain disciplinary actions. However, Granen acknowledged that such information is still a matter of public record, and must be provided if a caller specifically asks for it. DCA legal counsel Bob Miller suggested that staff receptionists be required to inform callers that disciplinary information is only provided for a specified period of time; if a caller requests information on actions taken prior to that period, the caller could be referred to a senior staff member in the Enforcement Division for response. Board members noted that, because formal disciplinary actions are imposed for more serious offenses than are citations/fines, perhaps they should be voluntarily disclosed for a longer period of time than citations/fines.

After discussion, the EPOC decided to make the following recommendations to the Board: (1) the Board will not voluntarily offer information regarding the issuance of a citation/fine after three years from the date of issuance; (2) the Board will not voluntarily offer information regarding the existence of a disciplinary action after seven years from the effective date of the decision (exceptions to this policy include revocations, reinstatements, and long-term probation); and (3) the issue of further exceptions to these policies will be referred to the Administrative Committee and Board staff for study and recommendation. EPOC clarified that disciplinary actions and citation/fine information would remain permanently in the Board's enforcement tracking system, and are public information even beyond the specified time periods; however, after the specified periods, the information will be removed from the computer screens of staff receptionists who respond to licensing inquiries. Further, staff receptionists will inform callers that disciplinary action information is available for seven years from the action, and that citation/

fine information is available for three years from the action. If a caller specifically requests information beyond the three- and seven-year periods, he/she will be referred to senior staff for response regardless of when the disciplinary action or citation/fine was issued.

At its March 20 meeting, the full Board approved the EPOC's recommendations.

## **Update on Board Rulemaking Proceedings**

The following is an update on recent BOA rulemaking proceedings described in detail in Volume 16, No. 1 (Winter 1999) of the *California Regulatory Law Reporter*:

♦ **Use of Mediation in Disciplinary Proceedings.** Following a public hearing at its March 20 meeting, BOA adopted proposed section 98.1, Title 16 of the CCR, regarding the use of mediation in Board disciplinary proceedings. [16:1 CRLR 186-87] The proposed regulation would incorporate by reference BOA's *California Board of Accountancy Mediation Guidelines*, previously approved by the Board at its September 1999 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. At this writing, the rulemaking record on the Board's adoption of section 98.1 is being prepared for review by the DCA Director.

♦ **Commissions: Disclosure Requirement.** On January 7, the Office of Administrative Law (OAL) approved BOA's adoption of new sections 56, 56.1, 56.2, and 56.3, and its amendment of section 95.2, Title 16 of the CCR. These sections implement SB 1289 (Calderon) (Chapter 41, Statutes of 1998), which amends section 5061 of the Business and Professions Code to permit—subject to certain restrictions—BOA licensees to pay a commission to obtain a client and accept a fee or commission for referring a client to the products or services of a third party, and requires the Board to adopt implementing regulations, including but not limited to regulations specifying disclosure requirements regarding commissions. [16:1 CRLR 185, 187-88]

Section 56(a) prohibits a Board licensee from accepting a fee or commission permitted by section 5061 unless he/she complies with the disclosure requirement in section 56 and with section 56.1. Subsection 56(b) requires the licensee to furnish the client, at or prior to the time the recommendation of the product or service is made, a written disclosure statement in 12-point type or larger that contains the following

information: (1) the fact that the fee or commission is to be paid for professional services, and that a fee or commission may not be accepted solely for the referral of the client to the products and services of a third party; (2) a description of the product(s) or service(s) which the licensee is recommending to the client, the identity of the third party that is expected to provide the product or service, the business relationship of the licensee to the third party, a description of any fee or commission which may be received by the licensee, including but not limited to any supplemental fee, commission, or other compensation allocable to the client being provided with the product or service of the third party (where the product(s) or service(s) cannot be specifically identified at the time of the initial disclosure, this information must be included in a supplemental disclosure within 30 days of receipt of the fee or commission); and (3) the dollar amount or value of the fee or commission payment(s), or the basis on which the payment(s) is being computed.

Under section 56(c), the written disclosure must be on the letterhead of the licensed firm or must be signed by the licensee. It must be signed and dated by the client, and must contain an acknowledgment by the client that the client has read and understands the information contained in the disclosure. The licensee must retain the disclosure statement for a period of five years and must provide a copy to the client.

Section 56.1 states that the professional services which must be provided by the licensee to the client in conjunction with the products or services of a third party under Business and Professions Code section 5061(b) must include consultation by the licensee with the client regarding the third party's product or service in relation to the client's circumstances.

Section 56.2 states that nothing in section 56 permits a licensee (1) to accept a fee or commission which would violate the requirement that a licensee be independent in the performance of services in accordance with professional standards, or (2) to concurrently engage in the practice of public accountancy and in any other business or occupation which impairs the licensee's independence or objectivity, or creates a conflict of interest in rendering professional services. Section 56.3 sets forth definitions of terms used in section 5061 and in its implementing regulations.

BOA also amended section 95.2, which sets forth a range of fines for violations of various sections of the Business and Professions Code and the California Code of Regulations. The Board updated the schedule of fines to establish a \$500-\$2,500 range of fines for violations of sections 56.1 and 56.2, Title 16 of the CCR, and for violation of section 5061.

♦ **Nonlicensee Owners of CPA Corporations.** At its September 1998 meeting, BOA adopted new section 51 and amended 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. [16:1 CRLR 185-86]



Section 51 would require, at initial registration and 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 would require 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. At this writing, the rulemaking file on this proposal is awaiting review by the DCA Director.

♦ **RQMC's Review of Licensee Financial Statements.** Also at its September 1998 meeting, BOA adopted proposed 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 (RQMC) as described in section 87.6, Title 16 of the CCR, in order to promote compliance with applicable accounting principles and reporting standards. BOA's proposed amendment to section 89.1 would clarify 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. BOA 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." [16:1 CRLR 186] At this writing, the rulemaking file on this proposal is awaiting review by the DCA Director.

♦ **Citations and Fines.** Also at its September 1998 meeting, BOA adopted proposed amendments to section 95.2, Title 16 of the CCR, which provides a range of fines for various violations of BOA statutes and regulations. This proposal would revise 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. [16:1 CRLR 186] At this writing, the rulemaking file on this proposal is awaiting review by the DCA Director.

## LEGISLATION

**SB 1306 (Business and Professions Committee)**, as amended April 12, would extend the "sunset" (expiration)

date of the Board until July 1, 2002 (see MAJOR PROJECTS). [S. Appr]

**AB 1667 (Consumer Protection Committee)**, as introduced March 15, would change the Board's name from "State Board of Accountancy" to "California Board of Accountancy," and make other minor technical changes to the Accountancy Act. [A. Appr]

**AB 1190 (Honda)**, as introduced February 26, would change the Board's name from "State Board of Accountancy" to "California Board of Accountancy." [A. CPGE&ED]

**AB 1016 (Briggs)**, as amended April 21, would provide that certain protections that apply to a communication between a taxpayer 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 taxpayer and an attorney. [A. Jud]

## LITIGATION

Following oral argument on February 19, Sacramento County Superior Court Judge Lloyd G. Connelly sustained the Board's demurrer and dismissed *KPMG Peat Marwick LLP, et al. v. State Board of Accountancy*, No. 98CS03254, which sought to interrupt an ongoing BOA disciplinary proceeding prior to the Board's final decision in the matter.

**Following oral argument on February 19, Sacramento County Superior Court Judge Lloyd G. Connelly sustained the Board's demurrer and dismissed KPMG Peat Marwick LLP, et al. v. State Board of Accountancy, which sought to interrupt an ongoing BOA disciplinary proceeding prior to the Board's final decision in the matter.**

proceeding prior to the Board's final decision in the matter. The dismissal—based solely on KPMG's failure to exhaust administrative remedies—was expected, as courts do not usually interfere with an ongoing agency adjudicative proceeding against a licensee until the agency has been afforded an

opportunity to complete its proceeding and determine whether to take disciplinary action.

In late 1998, BOA filed an accusation 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." Three days later, KPMG filed suit against 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..." [16:1 CRLR 178-82]

Among other things, KPMG alleged that (1) in the course of its investigation, BOA 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."

In its responsive pleading, 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. BOA 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, BOA 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.

**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.**

As noted, Judge Connelly sustained the Board's demurrer and dismissed KPMG's complaint, based on its failure to exhaust administrative remedies. KPMG has stated its intention to appeal Judge Connelly's decision.

On March 17, the California Supreme Court declined to review the Second District Court of Appeal's decision in *Arthur Andersen LLP v. Superior Court (Charles Quackenbush, Real Party in Interest)*, 67 Cal. App. 4th 1481 (Nov. 24, 1998). In that matter, the Second District held that CPAs owe a duty to the Insurance Commissioner to adequately disclose the financial condition of insurance companies, and may be liable to the Commissioner (as liquidator on behalf of the company's policyholders and creditors) for negligently-prepared audits of insurance companies. [16:1 CRLR 188-89] *Bily v. Arthur Young & Company*, 3 Cal. 4th 370 (1992), limits CPA liability for negligently-prepared audits to those with whom the CPA has privity of contract and certain other persons "who act in reliance upon those misrepresentations in a transaction which the auditor intended to influence." [12:4 CRLR 51-52] The Second District determined that the Insurance Commissioner—who is charged with monitoring insurance companies to ensure their ability to pay insurance claims, and to whom audits of insurance companies must be submitted—"is within the universe of persons to whom an auditor in [Andersen's] position may be liable for negligent misrepresentation in an audit report pursuant to...*Bily*." The Second District decided only the legal issue of whether Andersen owed a duty to the Commissioner under *Bily*, not whether Andersen was negligent in auditing financial statements; that issue has been remanded for trial in superior court.

## RECENT MEETINGS

At the Board's January meeting, Assistant Executive Officer Mary Crocker reported statistics from the November 1998 Uniform CPA Exam. Of 8,736 candidates who applied to take the exam, 7,389 actually sat for it. Only 276 candidates passed all four parts in one sitting; 1,398 candidates received "conditional credit" for passing some parts (meaning they do not have to retake the passed parts); and 1,103 completed their remaining unpassed parts at that sitting.

## FUTURE MEETINGS

- May 13-14, 1999 in San Francisco.
- July 15-16, 1999 in San Diego.
- September 16-17, 1999 in Los Angeles.
- 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.