CALIFORNIA BOARD OF ACCOUNTANCY

INITIAL STATEMENT OF REASONS

Hearing Date: Thursday, September 26, 2019

Subject Matter of Proposed Regulations: Peer Review Reporting - Firms

Section Affected: 45

<u>Problem being addressed</u>

The California Board of Accountancy (CBA) regulates the accounting profession in part by establishing and maintaining minimum standards for the protection of the public. The CBA currently regulates over 104,000 licensees, including individual Certified Public Accountants / Public Accountants (CPAs/PAs), accountancy partnerships and accountancy corporations, all of which are required to be separately licensed by the CBA (Accountancy Act – see Business and Professions Code (BPC), § 5000 et seq.).

Peer review is a systematic review of a firm's accounting and auditing services performed by a CPA peer reviewer who is unaffiliated with the firm being reviewed to ensure work performed conforms to professional standards. Existing law at BPC section 5076(a) requires a "firm," as defined in BPC section 5035.1,to have a peer review report of its accounting and auditing practice accepted by a CBA-recognized peer review program no less frequently than every three years in order to maintain licensure. BPC section 5035.1 defines a "firm" to mean a sole proprietorship, a corporation, or a partnership.

While Section 5076 makes it clear that peer review is a firm-based reporting requirement, the existing regulation at section 45(a) of title 16 of the California Code of Regulations (CCR) (Section 45(a)) requires <u>all</u> licensees including CPAs/PAs, accountancy partnerships and accountancy corporations to report peer review information on the Peer Review Reporting Form (Form PR-1) (Rev. 11/17) at the time of renewal.

The current requirement that all licensees, instead of "firms," report to the CBA has led to inaccurate reporting when both the firm licensees (corporation or partnership) and the individual CPA licensee working at an accountancy corporation or partnership submit renewal notices and the Form PR-1 to renew their respective licenses. The current version of Section 45 does not distinguish between CPAs who operate as sole proprietorships (i.e., running their own individual practice) and those who are not working independently (i.e., employed at accountancy partnerships or corporations).

Consequently, the current reporting process has resulted in increased deficiencies at the time of license renewal. For example, some licensees who work at an accountancy corporation or partnership are not reporting peer review information because their firms are reporting peer review even though Section 45 currently requires them, as a "licensee," to do so.

The proposed changes to Section 45 and Form PR-1 are designed to simplify the reporting process and make clear that licensees only need to report accounting and auditing services performed and peer review compliance if they are considered a “firm,” as defined in Section BPC 5035.1 (i.e., providing services as a sole proprietorship, corporation or partnership). Individual certified public accountants / public accountants (CPAs/PAs) working for an accountancy corporation or partnership licensee and those renewing in inactive or retired statuses would not be required to separately report compliance with peer review at the time of renewal. Rather, only licensees who are acting as “firms” would be required to do so. The proposed changes would help ensure peer review is being reported appropriately and reduce the aforementioned deficiency issues upon renewal for these types of licensees.

In addition, the current Form PR-1 includes questions to capture statistical information the CBA was mandated to report to the California Legislature and Governor by January 1, 2015 pursuant to BPC 5076(m). As the reporting period phase is complete, the PR-1 Form would be amended to delete those questions that were only needed for the CBA’s legislative report and reflect the most pertinent information for enforcement of the peer review program’s requirements.

<u>Anticipated benefits from this regulatory action</u>
This proposal would clarify that only licensees who operate as firms as defined in BPC 5035.1 would need to report specific peer review information. Individual CPAs/PAs not operating as firms and those renewing in inactive or retired statuses would not be required to report peer review information. This would improve licensees’ understanding of who is required to report peer review information, allow the CBA to ensure that the peer review requirement is properly enforced, and reduce the number of unnecessary forms mailed from the CBA and returned by licensees.

<u>Specific Purpose/Factual Basis/Rationale</u>
The CBA proposes the following amendments to Section 45:

<u>Section 45(a)</u>
The proposed amendment would specifically strike the word “licensee” from this section and replace it with “firm.”

- <u>Purpose</u>: The proposed amendment would clarify that, at the time of renewal, only a firm, as defined in Section 5035.1, shall report to the CBA specific peer review information as required on Form PR-1 (Rev. 6/19), which would be incorporated by reference.
- <u>Rationale</u>: Proposed changes to the text of Section 45 and its form are necessary to conform the regulation to statute, help simplify the reporting process and make it clearer that licensees only need to report accounting and auditing services performed and peer review compliance if considered a “firm,” as defined.

<u>Section 45(b)</u>
This subsection allowed licensees, during implementation of the program, to report peer review information in phases according to a schedule.

- <u>Purpose</u>: The proposed amendment eliminates an obsolete subdivision of Section 45, which was only used during initial program implementation prior to January 1, 2014. Currently, licensees report peer review compliance on a biennial basis at the time of renewal.
- <u>Rationale</u>: Proposed changes to the text of Section 45 and its form are necessary to remove outdated information and help simplify the reporting process.

<u>Section 45(c)</u>
The proposed amendment renumbers 45(c) to 45(b) and changes the form revision date consistent with the changes proposed in this rulemaking. It also adds the term "firm's" with respect to who is subject to disciplinary action as provided in this section. This proposal would revise Form PR-1 (Rev. 11/17) and replace it with Form PR-1 (Rev. 6/19). In addition, obsolete questions to capture statistical information for the purpose of reporting to the California Legislature by January 1, 2015 are also being removed from the form.

- <u>Purpose</u>: This proposed amendment renumbers 45(c) to 45(b) due to the deletion of questions on the form, clarifies that firms are responsible and will be subject to disciplinary action if the firm makes any false, fraudulent, or misleading statements as a part of, or in support of, its peer review reporting. Individual licensees will continue to be held responsible for false, fraudulent, or misleading statements as part of the firms' peer review reporting.
- <u>Rationale</u>: Proposed changes to the text of Section 45 and its form are necessary to conform the regulation to statute, remove outdated information, help simplify the reporting process and make it clearer that licensees need to report accounting and auditing services performed and peer review compliance only if considered a "firm," as defined. Amendment of this form is necessary to create a simpler process for licensees to comply with the renewal requirements for peer review and implement the requirements of BPC Section 5076.

PR-1 (Rev. 6/19) contains the following proposed changes:

(1) <u>Question 1 and Form Title</u>: The word "licensee" is being stricken.

- <u>Purpose</u>: The word "licensee" is being stricken to clarify that only firms are subject to this reporting requirement.
- <u>Rationale</u>: The proposed changes to Question 1 and Form Title are necessary to conform the form to statute, help simplify the reporting process and make it clearer that licensees only need to report accounting and auditing services performed and peer review compliance if considered a "firm," as defined.

(2) New Question 2: The proposed amendment will add a separate line for the licensee to insert his or her name.

- Purpose: This is necessary for the CBA to know which firm licensee completed the form for enforcement purposes, and to ensure that the form is completed by a firm representative.
- Rationale: The proposed changes are necessary to identify which licensee completed the form for enforcement purposes, and help simplify the reporting process.

(3) Question 6: This question currently asks whether a licensee is operating as an accounting firm and asks the licensee to check a box (yes/no) to identify whether they are considered an accounting firm. Under this proposal the question would be revised to ask that the type of accounting firm be identified (either Sole Proprietorship, General Partnership, Limited Liability Partnership, or Corporation). In addition, a sentence would be added, in parenthesis, to help explain that a sole proprietorship is simply an individual who works independently.

- Purpose: The proposed changes help firms determine which box to check on the form, since the form will only be completed by those licensees operating as an accounting "firm."
- Rationale: The proposed changes are necessary to conform the form to statute, help simplify the reporting process and make it clearer that licensees only need to report accounting and auditing services performed and peer review compliance if considered a "firm," as defined.

(4) Questions 7, 11a, 11b, 12, 13, and 14: This proposal would delete these questions from the Form.

- Purpose: These questions gather information that was collected from licensees for the purpose of preparing the CBA's January 1, 2015 report to the Legislature (e.g., firm size, identity of peer review administrator, highest level of accounting and auditing service performed, cost of peer review, and time spent preparing for the review). Since this report has been completed, the information is no longer needed.
- Rationale: The proposed changes are necessary to help simplify the reporting process and make it clearer that licensees only need to report accounting and auditing services performed and peer review compliance if considered a "firm," as defined.

(5) New Question 11: A new question regarding whether the peer review was administered by a Board-recognized peer review provider is being added.

- Purpose: The purpose of this new question is to confirm that a peer review is performed by a Board-recognized peer review program provider.

- Rationale: This question is necessary to help simplify the reporting process in confirming compliance with the requirement in BPC 5076 that a peer review is performed by a Board-recognized peer review program provider, which administers peer review in accordance with CBA laws and regulations and in accordance with established peer review standards. There is currently one Board-recognized peer review program provider, the American Institute of Certified Public Accountants (AICPA). Although the CBA provides the option of allowing other organizations to apply to become Board-approved peer review program provider, due to the size and scale of the program, it is unlikely this would occur.

(6) Amendment to Personal Information and Collection Access Notice (Information Practices Act (IPA) Notice – Civil Code section 1798.17): The current IPA notice broadly cites to statutory provisions relating to qualifications for CPA licensure.

- Purpose: This proposal would correct and revise those citations to more specifically refer to the authority to collect personal information under the peer review program as set forth in BPC section 5076 and Section 45.
- Rationale: The amendments are intended to comply with the notice requirement for the collection of "personal information" in Civil Code section 1798.17.

Consumer Protection Benefits Anticipated

The CBA's mission is to protect consumers. This proposal would allow the CBA to better protect consumers by clarifying the peer review reporting requirement, which will improve accurate reporting by licensees and support the CBA's monitoring of compliance with the peer review requirement.

Underlying Data

Technical, theoretical, or empirical studies, reports, or documents relied upon:

- Minutes and meeting materials of the September 17-18, 2015 CBA Meeting. (Item VIII.B.5 – Discussion to Explore Methods to Identify Sole Proprietorships for California Board of Accountancy Peer Review Reports and Other Reporting Purposes.)

- Minutes and meeting materials of the September 17-18, 2015 CBA's Committee on Professional Conduct Meeting. (Item V. - Discussion to Explore Methods to Identify Sole Proprietorships for California Board of Accountancy Peer Review Reports and Other Reporting Purposes.)

- Minutes and meeting materials of the July 21, 2016 CBA Meeting. (Item IX.A.2. – Discussion and Possible Action to Initiate a Rulemaking to Amend Title 16, California Code of Regulations Section 45 – Reporting to the Board.)

- Minutes and meeting materials of the July 21, 2016 CBA's Committee on Professional Conduct Meeting. (Item IX.A.2. of the July 21-22, 2016 – Discussion and Possible Action to Initiate a Rulemaking to Amend Title 16, California Code of Regulations Section 45 – Reporting to the Board.)

Business Impact

This regulation will not have a significant adverse economic impact on businesses. This initial determination is based on the following facts or evidence/documents/testimony:

- This proposal impacts Certified Public Accountant (CPA) firms, of which the CBA in FY 2015-16 renewed 1,791 corporations, 671 partnerships, and an unknown number of CPA licensees who work as sole proprietors. The CBA does not track how many of its licensees are working as sole proprietors or small businesses.

- The proposal would change who will be required to report peer review information to the CBA. Instead of having all licensees report whether they are subject to peer review, only those licensees operating as a "firm" (i.e. a sole proprietorship, accountancy corporation, or accountancy partnership) will be required to report specified peer review information on the licensee's renewal date, which occurs once every two years. This means that fewer CPAs will have reporting requirements, which will result in some cost savings (postage and staff time) for CPA licensees who are retired, inactive or who do not provide accounting services as a sole proprietorship.
- For those firms still subject to this requirement, the entire reporting process should continue to take no more than five minutes to complete. Since there should be no additional time or cost anticipated as a result of these proposed changes, the cost impact to licensees is considered negligible. While expenses associated with submitting the form continue to include mailing, these expenses are currently being made by these firms. These costs are minimal and will not have a significant fiscal impact on these firms.

Economic Impact Assessment

This regulatory proposal will have the following effects:

- It will not create or eliminate jobs within the State of California because the entire reporting process, as described in this proposal, should take no more than five minutes to complete and involve minor postage costs. With minor postage and a completion time of five minutes every two years, the impact is considered negligible. In addition, a number of licensees will no longer be required to report peer review since they do not operate as a firm.

- It will not create new businesses or eliminate existing businesses within the State of California because the entire reporting process, as described in this proposal, should take no more than five minutes to complete and involves minor postage costs. With minor postage and a completion time of five minutes every two years, the impact is considered negligible. In addition, a number of licensees will no longer be required to report peer review since they do not operate as a firm.

- It will not affect the expansion of businesses currently doing business within the

State of California because the entire reporting process, as described in this proposal, should take no more than five minutes to complete and involve minor postage costs. With minor postage and a completion time of five minutes every two years, the impact is considered negligible. In addition, a number of licensees will no longer be required to report peer review since they do not operate as a firm.

- This regulatory proposal benefits the health and welfare of California residents because the proposal would allow the CBA to better protect consumers by clarifying reporting of peer review information, allow the CBA to enforce the peer review requirement, and reduce the number of unnecessary forms mailed from the CBA and returned by licensees.

- This regulatory proposal does not affect worker safety because it has nothing to do with worker safety.

- This regulatory proposal does not affect the state's environment because it has nothing to do with the environment.

Specific Technologies or Equipment

This regulation does not mandate the use of specific technologies or equipment.

Consideration of Alternatives

No reasonable alternative to the regulatory proposal would be either more effective in carrying out the purpose for which the action is proposed or would be as effective or less burdensome to affected private persons and equally effective in achieving the purposes of the regulation in a manner that ensures full compliance with the law being implemented or made specific.

Set forth below are the alternatives which were considered and the reasons each alternative was rejected:

The only alternative considered was to maintain the status quo. The CBA rejected this alternative because maintaining the status quo would not simplify the reporting process, improve licensees' understanding of who is required to report peer review information or eliminate unnecessary reporting. The status quo would result in a continued high number of renewal deficiencies. Failure to address this problem would continue to divert resources from the CBA's primary mission.
This proposal ensures proper compliance with the peer review requirement in the most efficient way possible, enabling the CBA to conserve resources and focus on its mission of consumer protection.