CALIFORNIA BOARD OF ACCOUNTANCY

INITIAL STATEMENT OF REASONS

Hearing Date: A hearing is scheduled for Thursday, September 16, 2021.

Subject Matter of Proposed Regulations: Sale, Transfer, or Discontinuance of Licensee's Practice

Sections Added: 54.3 and 54.4, Article 9, Division 1, Title 16 of the California Code of Regulations (CCR)

The California Board of Accountancy (CBA) regulates the accounting profession in part by establishing and maintaining minimum standards of practice for the protection of the public. The CBA currently regulates over 100,000 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 and following).

<u>Problems being addressed:</u>

Pursuant to BPC section 5018, licensees are required to adhere to the rules and standards of professional conduct adopted by the CBA, which are set forth in Title 16, Division 1, Article 9 of the California Code of Regulations[1]. The CBA requires licensees to comply with all applicable professional standards, including the Code of Professional Conduct developed by the American Institute of Certified Public Accountants[2] (AICPA). (See Cal. Code Regs., tit. 16, section 58 ["Licensees engaged in the practice of public accountancy shall comply with all applicable professional standards"].) The Code of Professional Conduct is a set of principles, rules, and interpretations that guide CPAs in the performance of their professional responsibilities, and it applies to California licensees pursuant to CCR section 58.

In October 2016, the AICPA Professional Ethics Executive Committee (PEEC) adopted new and revised interpretations (Interpretations) of the AICPA Code of Professional Conduct to provide guidelines about their scope and application.

The CBA has determined that additional detail is reasonably necessary to implement the following PEEC Interpretations:

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[1] All references to the California Code of Regulations are to Title 16, unless otherwise indicated.

[2] The AICPA is the world's largest member association representing the accounting profession with a history of serving the public interest since 1887. It sets ethical standards for the accounting profession and U.S. auditing standards for private companies, nonprofit organizations, and federal, state, and local governments.

- 1.400.205: Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice (New Interpretation)

- 1.700.050: Disclosing Client Information in Connection With a Review or Acquisition of Member's Practice (Revised Interpretation)

While these PEEC Interpretations provide information to a licensee, they lack detail regarding implementation. The CBA's proposed regulations are intended to provide the additional needed detail.

The regulatory proposals being presented are consistent with the recent PEEC interpretations and ensure safeguards are in place for consumers. They are consistent with existing laws, specifically BPC section 5097, which identifies record retention timeframes, Civil Code section 1798.81, which relates to the destruction of records, and BPC section 5063.3, which prohibits the disclosure of a client or prospective client's confidential information, except under certain circumstances. Further, the proposed regulations are consistent with existing regulations, CCR Section 54, which defines confidential information; and Section 54.1, which sets forth the circumstances under which a client or potential client's confidential information may be disclosed.

New Interpretation -- section 1.400.205, "Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice"

This Interpretation went into effect on June 30, 2017. It provides guidelines regarding transferring or returning client records during the sale, transfer, discontinuance or acquisition of a practice; however, additional detail is needed to implement this section to ensure confidential information of affected consumers is protected.

- Sale or Transfer of Practice
  The Interpretation for section 1.400.205 of the AICPA Code of Professional Conduct recommends that Members[3] submit a written request to each client subject to the sale or transfer requesting their consent to transfer the client's files to the successor firm and encourages the Member to retain evidence of the client's consent.

  Proposed Section 54.3 would require licensees to seek such consent and specify the manner and form by which this must occur, as discussed in detail below. Licensees would be required to mail and retain a copy of the written notice regarding the sale or transfer and retain any documentation indicating the client's consent or objection for a specified period of time.

[3] The use of the term "Member" or "Members" refers to the CPA members of AICPA.

In addition, the Interpretation recommends that, if the Member is unable to contact the client, client files and records that are not transferred should be retained in a confidential manner and according to the firm's record retention policy or pursuant to applicable state law or regulation, whichever is longer. Proposed Section 54.3 would require the licensee to retain the client files and records for a specific period of time and establish an appropriate method of disposal once the record retention period has concluded.

- <u>Discontinuance of Practice</u>
  The Interpretation for section 1.400.205 of the AICPA Code of Professional Conduct recommends that a member, who discontinues practice and does not sell or transfer the practice, notify each of the member's clients. Proposed Section 54.4 would require licensees to notify the client and specify the manner by which they must do so, as described in detail below.

Revised Interpretation -- section 1.700.050, "Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice" went into effect October 31, 2016. This Interpretation provides guidance regarding preserving clients' confidential information when a licensee's practice is reviewed, or a licensee reviews a practice, in conjunction with a prospective purchase, sale, or merger of all or part of a licensee's practice; however, additional detail is needed to implement this section to ensure confidential information of affected consumers is protected.

This Interpretation recommends that Members, who obtain client files as the result of acquiring all or part of a practice, not disclose any confidential client information that is contained in such files and refers Members to section 1.400.205 for guidance regarding the handling client files obtained pursuant to an acquisition. The CBA's proposed Section 54.3 would set forth specific requirements regarding the handling of client files pursuant to the sale or transfer of a practice, as described in detail below.

<u>Anticipated benefits from this regulatory action:</u>

The CBA's proposed regulations would establish procedures for licensees to follow when selling, transferring or discontinuing their practice in order to protect the confidential information of affected consumers. In addition, the proposal would create requirements for the appropriate handling of client records, including the manner of disposal, which further enhances consumer protection.

<u>Specific Purpose/Factual Basis/Rationale:</u>

The CBA proposes to adopt sections 54.3 and 54.4 of Title 16 in the CCR.

Section 54.3

This proposed section proposes various requirements that a licensee would be required to comply with when selling or transferring all or part of their practice to a successor licensee and not retaining any ownership interest in the practice. This portion of the CBA's proposal provides additional needed detail regarding new Interpretation 1.400.205, Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of Practice, one of the professional standards that CBA licensees are required to comply with pursuant to Section 58.

Section 54.3(a)

The CBA is proposing to require licensees that sell or transfer all or part of their practice to a successor licensee and will not retain any ownership in the practice to send, via first-class mail, a written notice regarding the sale or transfer to the last known address of each client that may be subject to the sale or transfer. The CBA's proposal would require that the notice include a request for consent to transfer the client's files or records to the successor licensee and a notice indicating that, if the client fails to notify the licensee within 90 days of the date of the notice that the client objects to the transfer, consent will be presumed. The regulation would also prohibit the licensee from transferring any client files or records to the successor licensee until the earlier of the following: (1) the licensee obtains the client's consent; or (2) the date specified in the notice, which shall be at least 90 days after the date of the notice.

The notification requirement is reasonably necessary to ensure that affected clients will be aware of the possibility that their confidential information may be transferred to another licensee and provide these clients with the opportunity to determine whether they would like their records transferred to the successor licensee or if they would like to make arrangements to have their records returned. It is reasonably necessary that the notice be in writing to ensure that the details of the notification are documented and to allow the CBA to evaluate licensees' compliance with the notice requirement. The notification requirement is consistent with BPC section 5063.3, which requires licensees obtain the client's consent to disclose client confidential information obtained pursuant to the licensees' accountancy practice, except in certain circumstances. It is also consistent with the AICPA's "Confidential Client Information Rule," which requires the CPA to obtain consent from the client prior to disclosing any confidential client information. It is reasonably necessary that the notice be sent via first-class mail to the client's last known address to ensure that the notice is promptly and accurately delivered to the client. First class mail was identified as it is a standard mode of communication for business items and does not require additional costs or burdens of required signatures.

The CBA proposes that the notice include a statement that failure of the client to object within 90 days from the date of the notice will result in the client's consent being presumed. This is reasonably necessary because, despite a licensee's best efforts, they may face situations in which they are unsuccessful in reaching a client or a client may not respond to the notice. The 90-day timeframe balances time for the client to object to the disclosure of their confidential information to the successor licensee with the licensee's ability to sell their practice. It provides a reasonable amount of time for the consumer to respond and provides a set date for the licensee to either make arrangements with the client to return the records or presume consent so that the sale or merger may proceed after a reasonable period of time has passed. Additionally, this timeframe is consistent with the Interpretation for section 1.400.205 of the AICPA's Code of Professional Conduct, which specifies that a client's consent to transfer their files to the successor firm may be presumed after a period of not less than 90 days. To ensure that licensees do not transfer a client's records or files before the client has had an opportunity to respond to the notice, the CBA proposes that the regulation specifically state that the licensee may not transfer files and records until the client consents or the objection period lapses.

Section 54.3(a) also proposes to require that licensees retain the notice and any documentation regarding the client's consent or objection to the sale or transfer of the client's files. This is reasonably necessary to allow the CBA to evaluate its licensees' compliance with the notice and retention requirements. Also, to ensure consistency with other CBA requirements, such as audit document retention, the CBA proposes that all notice documentation be retained for a period of seven years. The seven-year time period is consistent with the timeframe for audit document retention specified in BPC section 5097(e)[4]. As a client's records could include audit documentation, keeping the retention timeframe consistent with BPC 5097(e) is reasonably necessary to ensure that audit documentation is retained as required by statute. Further, a seven-year record retention timeframe is familiar to licensees, and it provides a reasonable period of time for the CBA to audit compliance with the requirement.

<u>Section 54.3(b)</u>

The CBA proposes that in instances where the client objects to the transfer of their files or records to a successor licensee, the licensee be required to return the client's records promptly, or as agreed upon with the client. Providing two methods on the timeframe for return of the clients' records, which could be viewed as a primary method and an alternative method, provides maximum flexibility for both the licensee and the client. The onus is on the licensee to return the records promptly, meaning within a reasonable period of time following the notification of the sale or transfer of the licensee's practice. Including the "as agreed upon with the client" enables the client and licensee to arrange a sooner or later timeframe based on the need for the records

[4] BPC section 5097(e) requires licensees to maintain audit documentation for a minimum of seven years.

Section 54.3(c)
The CBA proposes to establish requirements relating to the handling of client files or records that are not subject to the sale or transfer of the licensee's practice. For instance, when a licensee winds up a practice, there may be inactive client files that will not be subject to the sale or transfer. With respect to such files, the CBA proposes that the licensee be required to return the records to the client or retain and dispose of them as they would when discontinuing a practice. This would ensure the client can determine the disposition of their records within a reasonable period of time.

Section 54.3(d)
If the licensee is unable to return a client's files or records, for example, if the licensee is unable to reach a client regarding the return or transfer of the client's files or records, the CBA proposes that the licensee retain such documents for a minimum of seven years from the sale or transfer of the licensee's practice.

The regulations will require licensees to notify clients of the sale or transfer of the practice via first class mail, which would result in costs of $0.55 (domestic) and $1.20 (international) per notification. The CBA cannot provide an estimate of the total future costs related to notifying clients because the number of notifications would depend on unknown variables including: 1) the number of future sale or transfers of practices, and 2) the number and location of clients impacted.

Licensees would also be required to either transfer client files to the successor licensee or to the client, as specified, or retain the files, as specified. Because any client file transfer and/or retention costs would also depend on these same unknown variables, the CBA cannot provide an estimate of these transfer or retention costs.

However, the CBA notes most client files are typically retained by the licensee in digital format and any transfer or retention of these files would occur digitally, which would not likely result in additional costs.

The CBA further notes a typical licensee opting to sell or transfer their practice would likely be averse to significant file transfer or retention costs. As a result, these individuals would probably choose to digitize any files as part of their normal course of business and complete the digitizing of files prior to the sale or transfer to eliminate these potential costs.

The CBA is aware that the reference to "unable" in the proposed text may need to be amended to provide more clarity. Input through the 15-day comment period will assist in determining this and potentially how this terminology will impact the affected group (CPAs and Accounting Firms).

The seven-year time period is consistent with the timeframe for audit document retention specified in BPC section 5097. As a client's records could include audit documentation, keeping the retention timeframe consistent with BPC 5097 is reasonably necessary to ensure that audit documentation is retained as required by statute. Seven years is also a familiar record retention period for licensees, provides a reasonable period for clients to obtain their files or records before they are destroyed, and provides a reasonable period of time for CBA to audit compliance with the requirement. Regardless of the status of the individuals license, the CBA maintains jurisdiction and authority to discipline, per BPC 5109, which states:

> The expiration, cancellation, forfeiture, or suspension of a license, practice privilege, or other authority to practice public accountancy by operation of law or by order or decision of the board or a court of law, the placement of a license on a retired status, or the voluntary surrender of a license by a licensee shall not deprive the board of jurisdiction to commence or proceed with any investigation of or action or disciplinary proceeding against the licensee, or to render a decision suspending or revoking the license.

Once the seven-year timeframe has elapsed, the proposed regulation would require the licensee to dispose of the records by shredding, erasing, or otherwise modifying the personal information to make it unreadable through any means. This would ensure that the licensee does not retain a client's confidential information for an unlimited amount of time. The manner of disposal is consistent with the record disposal requirements for businesses set forth in section 1798.81 of the Civil Code[5], which would ensure that none of the client's confidential information is compromised when the licensee disposes of them.

Section 54.4

This section proposes requirements that licensees must follow when discontinuing their practice without a sale or transfer of the practice. The proposed regulations, as outlined below, provide additional needed detail regarding new Interpretation 1.400.205, Transfer of Files and Return of Client Records in Sale, Transfer, or Discontinuance or Acquisition of a Practice, Discontinuance of Member's Practice, one of the professional standards that CBA licensees are required to comply with pursuant to Section 58.

[5] Civil Code section 1798.81 requires businesses to, "take all reasonable steps to dispose, or arrange for the disposal, of customer records within its custody or control containing personal information when the records are no longer to be retained by the business by (a) shredding, (b) erasing, or (c) otherwise modifying the personal information in those records to make it unreadable or undecipherable through any means."

Section 54.4(a)
The CBA is proposing to require licensees that discontinue their practice without a sale or transfer to a successor licensee to send a written notice regarding the discontinuance of the practice via first class mail to each client at their last known address and return the client's records promptly or as agreed upon with the client. The notice requirement is reasonably necessary to ensure that clients are notified about the discontinuation of a licensee's practice and to provide clients with an opportunity to inquire about the disposition of their records. It is reasonably necessary that the notice be in writing to ensure that the details of the notification are documented and to allow the CBA to evaluate licensees' compliance. To ensure prompt and accurate delivery, it is reasonably necessary that the notice be sent via first-class mail to the last known address of the client. The requirement to return records promptly is reasonably necessary to ensure that clients will receive their records within a reasonable period of time.

Section 54.4(b)
The CBA proposes that in instances where the licensee is unable to return a client's files or records, for example if the client cannot be reached to return the client's files or records, the licensee would be required to retain the client's files or records for at least seven years after the discontinuance of the practice. After seven years, the licensee would be required to dispose of the records by shredding, erasing, or otherwise modifying the personal information to make it unreadable through any means.

The seven-year time period is consistent with the timeframe for audit document retention specified in BPC section 5097. As a client's records could include audit documentation, keeping the retention timeframe consistent with BPC 5097 is reasonably necessary to ensure that audit documentation is maintained as required by statute. Seven years is also a familiar record retention period for licensees, provides a reasonable amount of time for the client to become aware of the discontinued practice and seek to obtain their records before they are destroyed, and provides a reasonable period of time for the CBA to audit compliance with this requirement. Further, the manner by which a licensee would be required to dispose of the records is consistent with section 1798.81 of the Civil Code, which sets forth record disposal requirements for businesses, and is reasonably necessary to ensure that none of the client's confidential information is compromised when the licensee disposes of such records.

Consumer Protection

The CBA's mission is to protect consumers. This proposal would safeguard confidential client information when a licensee sells, transfers, or discontinues a practice by requiring licensees to follow specified procedures regarding notification, disclosure, retention, and disposal of client records. The CBA's proposal would protect consumers by ensuring a licensee notifies their clients of the sale, transfer, or discontinuance of their practice and would provide affected consumers with the opportunity to obtain their records from such a licensee. Further, the regulatory proposal would safeguard confidential client information when disposing of client files and records should that become necessary by requiring licensees to dispose of the files in a manner that would make the files unreadable or undecipherable through any means.

Underlying Data

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

- AICPA Code of Professional Conduct, New and Revised Ethical Interpretations, October 2016

- Minutes of the March 17-18, 2016 CBA Meeting

- March 17-18, 2016, CBA Item III.E. Exposure Draft Regarding the American Institute of Certified Public Accountants Professional Ethics Division's Omnibus Proposal Regarding Proposed Revisions to the American Institute of Certified Public Accountants Code of Professional Conduct

- Minutes of the January 26, 2017 CBA's Committee on Professional Conduct (CPC) Meeting

- January 26, 2017, CPC Item II. – Discussion and Possible Action on Proposed Legislative Language to Amend Business and Professions Code Section 5063.3 and to initiate a Rulemaking to Adopt Regulations Regarding the Sale or Transfer of a Licensee's Practice and for Client Notification of Discontinuance of Licensee's Practice

- Minutes of the January 26, 2017 CBA Meeting

- January 26, 2017, CBA Item VIII.A.2. – Discussion and Possible Action on Proposed Legislative Language to Amend Business and Professions Code Section 5063.3 and to initiate a Rulemaking to Adopt Regulations Regarding the Sale or Transfer of a Licensee's Practice and for Client Notification of Discontinuance of Licensee's Practice

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 reflects the AICPA interpretations 1.400.205 and 1.700.050 which apply to the accountancy profession within and outside of California. Licensees are already required to meet professional standards, which includes the AICPA interpretations, pursuant to CCR section 58.

- The AICPA interpretations are only recommendations for licensees to follow and the CBA proposal establishes them as requirements. Despite this, many of the requirements are common business practices that may be followed; and, as such would not have a significant impact.

<u>Economic Impact Assessment</u>

This regulatory proposal will have the following effects:

- It will not create or eliminate jobs within the State of California because the entire notification and record retention process is already recommended as part of the AICPA Code of Professional Conduct, which applies to the accountancy profession within and outside of California. Postage and storage costs will be paid by the licensee and depending on the format of the records (paper or hardcopy) could vary the mailing cost.

- It will not create new businesses or eliminate existing businesses within the State of California because the notification and record retention process is already recommended as part of the AICPA Code of Professional Conduct, which all licensees, within and outside of California, must adhere to. Because the rules will be applicable to all licensees, no one business will be impacted more or less than any other.

- It will not affect the expansion of businesses currently doing business within the State of California because the entire notification and record retention process is recommended to be followed by all licensees who sell, transfer, or discontinue their practice.

- This regulatory proposal benefits the health and welfare of California residents because the proposal would allow the CBA to better protect consumers by specifying that licensees and successor licensees, when selling, transferring, or discontinuing a practice, follow specified procedures regarding notification, disclosure, retention, and disposal of client files and records.

- 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.

- The CBA indicates that because licensees primarily already conform to the proposed regulations as they reflect and enhance upon the current standards of professional conduct, any economic impact for licensees and successor licensees to comply with these requirements are anticipated to be minimal.

Specific Technologies or Equipment

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

Consideration of Alternatives

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 provide licensees with sufficient guidance to comply with the Code of Professional Conduct and Interpretations as required by CCR section 58 selling, transferring, or discontinuing their practice. The interpretations provide broad guidance, but the proposed regulations provide more detailed steps to ensure consumer protection.