

# HOUSE BILL REPORT

## HB 1211

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**As Reported by House Committee On:**  
Commerce & Labor  
Appropriations

**Title:** An act relating to accountability requirements under the public accountancy act.

**Brief Description:** Modifying accountability requirements under the public accountancy act.

**Sponsors:** Representatives Conway, Chandler, Kenney, Wood, Hudgins, Cooper, Veloria, Schual-Berke, Lovick, Kirby, Dickerson, Upthegrove, McDermott, Rockefeller, Morrell, Murray, Simpson, Darneille, Chase, Cody and Ruderman.

**Brief History:**

**Committee Activity:**

Commerce & Labor: 1/29/03, 2/13/03 [DPS];  
Appropriations: 2/25/03, 2/26/03 [DPS(CL)].

**Brief Summary of Substitute Bill**

- Requires CPAs and CPA firms to notify the Board of Accountancy (Board) of certain compliance actions and investigations by specified federal agencies and state accountancy boards.
- Requires CPA firms to retain certain audit-related documents and records for seven years.
- Increases the Board's penalty authority from a maximum fine of \$10,000 to a maximum fine of \$30,000.
- Requires the Board to report to the Legislature on auditor independence by December 1, 2003.

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### HOUSE COMMITTEE ON COMMERCE & LABOR

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 7 members: Representatives Conway, Chair; Wood, Vice Chair; Chandler, Ranking Minority Member; Condotta, Assistant Ranking Minority Member; Holmquist, Kenney and McCoy.

**Staff:** Aaron Anderson (786-7119); Chris Cordes (786-7103).

## **Background:**

Accountants and accounting firms engaging in public accounting in Washington are governed by Washington's Public Accountancy Act (PAA). The PAA requires these persons and firms to obtain and maintain a certified public accountant (CPA) license. Fees must be assessed at a level adequate to administer the program. However, fee increases are limited by the amount of the fiscal growth factor unless larger increases are approved by the Legislature.

Some of these CPAs and CPA firms are also regulated by federal law and may be licensed in other states. Under Securities and Exchange Commission (SEC) rules, standards adopted by non-governmental entities, such as the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board, may apply to audits performed on publicly traded companies.

In 2002 the Congress enacted the Sarbanes-Oxley Act which created the Public Company Accounting Oversight Board (PCAOB) to oversee the auditing of public companies. The PCAOB must register public accounting firms that participate in the preparation of public company audits.

### Compliance Reporting and Penalties

The Board of Accountancy (Board) may take action against an individual's or firm's CPA license for violations of the PAA or conviction of any crime, and in response to suspension or revocation of the individual's or firm's CPA license by another state or the federal government. Similar action may be taken for violation of the Board's ethical or technical standards. CPAs and CPA firms and individuals, except those licensed through reciprocity with another jurisdiction, are not required to notify the Board of compliance actions taken by other states, the federal government, or non-governmental standard-setting entities, or of related investigations.

A CPA firm must give the Board notice within 90 days after changes in partners, shareholders, or other firm owners. If a CPA firm falls out of compliance due to changes in ownership or personnel, it must notify the board within 30 days after the change and make a proposal for coming back into compliance.

### Retention of Documents

The PAA does not require a CPA or a CPA firm to retain audit work papers or other documents.

The Sarbanes-Oxley Act directed the SEC to adopt rules specifying the documents that accountants must retain, and the retention period, when auditing publicly traded companies. These rules were adopted on January 23, 2003.

The new SEC rules require auditors to retain certain documents for seven years after an

audit. The documents to be retained include: workpapers and other documents that form the basis of the audit or review, and memoranda, correspondence, communications, other documents, and records (including electronic records), which are created, sent, or received in connection with the audit or review, and contain conclusions, opinions, analyses, or financial data related to the audit or review.

#### Auditor Independence

The PAA does not specifically require CPAs or CPA firms to be independent of entities they audit. Board rules, however, prohibit CPAs and CPA firms from having a financial interest in the entities they audit. Further, Board policy requires CPAs and CPA firms to avoid offering services where actual or perceived conflicts of interest exist.

On October 25, 2002, the Board established an Independence Committee (Committee) to review the Board's current independence rule and develop a draft independence rule. The Committee is scheduled to present its draft to the Board on July 26, 2003.

The Sarbanes-Oxley Act required the SEC to expand its rules regarding the independence of accountants from the companies they audit. These rules, adopted January 22, 2003, prohibit regulated accountants and firms from providing a wide variety of services that could result in conflicts of interest, including information technology, bookkeeping, financial systems design, personnel services, and legal services. The rules allow the provision of tax services.

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### **Summary of Substitute Bill:**

#### Compliance Reporting and Penalties

CPAs and CPA firms are required to notify the Board within 30 days after suspension, revocation, or modification of their license or practice rights by the SEC, the PCAOB, or another state Board of Accountancy. CPAs and CPA firms must also notify the Board within 30 days after notification of investigations by the SEC or the PCAOB related to their license, practice rights, or violation of ethical or technical standards. The Board is granted rule-making power to implement these requirements and, as needed to protect the public interest, to require reporting of other investigations or sanctions.

The time period for licensed firms to notify the Board after falling out of compliance due to changes in ownership or personnel is increased from 30 to 90 days.

The Board's penalty authority for violations of the PAA is increased from a maximum of \$10,000 to a maximum of \$30,000. The monetary penalty for a violation of the PAA that is punishable as a crime is increased from a maximum of \$10,000 to a maximum of \$30,000.

#### Retention of Documents

Licensed CPA firms are required to retain certain documents and records for seven years after the end of the fiscal period in which the firm conducted an audit or review of a client's financial statements. The Board of Accountancy is granted rule-making power to implement the document retention requirements.

Auditor Independence

The Board is required to report to the Legislature on auditor independence by December 1, 2003.

Fees

The Board is allowed to increase fees above the fiscal growth factor if necessary to fully fund the costs of administering these provisions.

**Substitute Bill Compared to Original Bill:**

Compliance Reporting

The substitute bill removes the broad requirements to self-report sanctions or investigations by any federal or state agency and limits the self-reporting requirement to license suspension, revocation, or modification by the SEC, the PCAOB, or another state board of accountancy. The self-reporting requirement for investigations is limited to notices from the SEC or the PCAOB. The Board is allowed to adopt rules covering other sanctions or investigations that must be reported, as needed to protect the public interest.

Document Retention

The substitute bill removes references to "compilations" from the retention requirement; only those records relevant to the audit or review are covered. The detailed list of documents to be retained is removed, and the uniform definition of "working papers" is removed. The Board is required to adopt rules to implement the retention section.

Fees

The substitute bill adds a provision allowing the Board to increase fees above the fiscal growth factor if necessary to fully fund the costs of administering these provisions.

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**Appropriation:** None.

**Fiscal Note:** Requested.

**Effective Date of Substitute Bill:** The bill takes effect 90 days after adjournment of session in which bill is passed.

**Testimony For:** All of the provisions of this bill will support public protection. Retention requirement should be aligned with new SEC retention rules. Notification

requirements assist state investigations. Other states were investigating firms involved in recent events, but our state was not informed of these investigations. The bill's increase in the Board of Accountancy's fining authority will help, because the current dollar amount is insignificant in larger cases. The technical correction for reporting changes in firm ownership is helpful. The requirement for a report on auditor independence is not difficult for the Board to meet.

(In support, with concerns) Retention requirements should exclude nonsignificant emails. Bill language should address licensed firms only, not all firms. Compilations should not be covered by this bill. Compliance with reporting requirements of this bill is complex for large, national firms, and the Board of Accountancy will also be burdened by looking at all of the reports received under the bill. The fiscal impact of the reporting requirements needs to be examined. Rules will be needed to clarify this legislation. Any investigation information received needs to be confidential. Small firms would be devastated by the increased fining authority; proportionality is needed.

**Testimony Against:** None.

**Testified:** Robby Stern, Washington State Labor Council; James Caley, Laurie Tish, and Dana McInturff, Washington State Board of Accountancy; Jim Boldt and Jim Coates, Washington State Certified Public Accountants; and Gary Smith, Independent Business Association.

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## HOUSE COMMITTEE ON APPROPRIATIONS

**Majority Report:** The substitute bill by Committee on Commerce & Labor be substituted therefor and the substitute bill do pass. Signed by 23 members: Representatives Sommers, Chair; Fromhold, Vice Chair; Sehlin, Ranking Minority Member; Pearson, Assistant Ranking Minority Member; Alexander, Boldt, Clements, Cody, Conway, Cox, DeBolt, Dunshee, Hunter, Kagi, Kenney, Linville, McDonald, McIntire, Miloscia, Ruderman, Schual-Berke, Sump and Talcott.

**Staff:** Amy Skei (786-7140).

### **Summary of Recommendation of Committee On Appropriations Compared to Recommendation of Committee On Commerce & Labor:**

No new changes were recommended.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Substitute Bill:** The bill takes effect 90 days after adjournment of

session in which bill is passed.

**Testimony For:** This state has suffered major losses in investment income from the recent dramatic fall in stock prices. One factor was that stock owners were not communicating the value of publicly owned corporations. Congress responded by passing the Sarbanes-Oxley Act to increase Securities and Exchange Commission oversight over publicly-owned companies. This state licenses accountants and needs to be involved in the effort to insure auditor independence. This bill has been worked out with the Board of Accountancy. The new fine penalty would be closer to California's level and still far below the federal fines. This bill would take active steps to restore investor confidence in publicly-owned corporations.

**Testimony Against:** None.

**Testified:** Representative Conway, prime sponsor; and Mel Curtiss, Washington State Board of Accountancy.