Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Commerce & Labor Committee

HB 1211

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 Summary of Bill

- Requires firms and individuals to notify the Board of Accountancy of certain compliance actions and investigations by federal or state agencies.
- 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.

Hearing Date: 1/29/03

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. 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.

<u>Compliance Reporting and Penalties</u>

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 are not required to notify the Board of compliance actions taken by other states, the federal government, or non-governmental standard-setting entities; nor are they required to notify the Board 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.

In 2002, the Congress enacted the Sarbanes-Oxley Act, which 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 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.

Summary of Bill:

Compliance Reporting and Penalties

CPAs and CPA firms are required to notify the Board within 30 days after sanction, suspension, revocation, or modification of their license by the SEC, Internal Revenue Service, or another state Board of Accountancy, or sanction or order against the CPA or CPA firm by any federal or other state agency related to their licensee's practice or violation of ethical or technical standards. CPAs and CPA firms must also notify the Board within 30 days after notification of related investigations. The Board is granted rule-making power to implement these requirements.

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, review, or compilation of a client's financial statements. These documents are "working papers" that form the basis of the audit, review, or compilation, along with other documents created, sent, or received in connection with the engagement and containing information related to the engagement. Firms are required to retain these documents whether the information supports or casts doubt on the final conclusions of the engagement.

The Board of Accountancy is granted rule-making power to implement the document retention requirements and create other related rules.

A uniform definition of "working papers" is created for the PAA. Under this definition, "working papers" means documentation of procedures applied, evidence obtained, and conclusions reached related to any professional service offered by a licensee, certificate holder, or nonlicensee owner, including documentation of a subsequent review of the licensee's work.

Auditor Independence

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

Appropriation: None.

Fiscal Note: Requested.

Effective Date: Ninety days after adjournment of session in which bill is passed.