

- SUBJECT:** Continuing the Board of Public Accountancy and changing its functions
- COMMITTEE:** Licensing and Administrative Procedures — committee substitute recommended
- VOTE:** 9 ayes — Flores, Hamilton, Raymond, Driver, Eissler, Goolsby, Homer, Jones, Wise
0 nays
- WITNESSES:** For — (*On original bill:*) Luke Metzger, Texas Public Interest Research Group/Tex PIRG; Johanna V. Peery, Texas Association of Certified Public Accountants; Rob Schneider, Consumers Union; Randy Sweeton (*On committee substitute:*) Robert Owen and Stanley E. Winters, Texas Society of Certified Public Accountants
Against — None
- BACKGROUND:** The Board of Public Accountancy consists of 15 members responsible for licensing certified public accountants (CPAs) and CPA firms and enforcing the provisions of the Public Accountancy Act, Occupations Code, Ch. 901. The board adopts rules, oversees executive administration, and may appoint advisory committee members who are not part of the board.
- The board may penalize a person who violates the Public Accountancy Act or a rule or order adopted or issued pursuant the act. It may revoke or suspend the license of a CPA or firm, impose an administrative penalty not exceeding \$1,000 for each violation of the act, and enjoin a non-certified person from practicing public accountancy. A violation of the act is a class B misdemeanor (up to 180 days in jail and/or a maximum fine of \$2,000).
- The 76th and 77th Legislatures created a pilot project, which took effect in September 2001, allowing more fiscal autonomy for the board. The board deposits its collected fees, fines, and other money into a trust fund in the treasury and withdraws funds as needed to meet its budget, which it adopts independent of legislative appropriation and oversight. The board may not

charge any cost, including salaries, to general revenue. Accordingly, the board employed no state workers, and its budget was \$728,516 for fiscal 2002-03.

The federal Sarbanes-Oxley Act of 2002 regulates some practices of public accounting firms by requiring them to register before auditing clients. The act:

- lists eight services that accounting firms may not provide their audit clients;
- requires certain audit partners of larger firms to leave a client after five years for a “time out” period of five years and subjects other audit partners to rotation after seven years; and
- compels a one-year “cooling off” period before a member of an audit team may accept employment doing work for a client.

Most of these provisions already are in effect. The U.S. General Accounting Office is studying some requirements for a report due out later this year. The Sarbanes-Oxley Act holds that state regulators should determine proper restrictions for accounting firms not covered by the act.

The Board of Public Accountancy will expire September 1, 2003, unless continued by the 78th Legislature.

DIGEST: HB 1218 would continue the Board of Public Accountancy and its functions until September 1, 2015, and revise the Public Accountancy Act.

Enforcement. CSHB 1218 would authorize the accounting board to:

- subpoena witnesses and documents, photocopy subpoenaed documents, enforce subpoenas through the attorney general, and administer oaths and take testimony;
- order a \$100,000 penalty against a license holder for each violation of the act;
- issue a cease and desist order against a person engaged in the unauthorized practice of public accountancy and fine a violator of the order \$25,000;
- disclose certain confidential information to other government agencies engaged in an enforcement action; and

- require a license holder to pay restitution or submit to a combination of current administrative sanctions following a violation of the act.

CSHB 1218 also would allow the board to order restitution to a person harmed by a breach of contract committed by a licensed accountant in the state. The restitution could not exceed the amount paid by the injured party.

The bill would authorize the board to suspend a license on an emergency basis without notice or hearing after determining that:

- a license holder was engaged in or about to engage in fraud; or
- a license holder was engaged in or about to engage in a violation of the Public Accountancy Act; and
- the practice was an immediate threat to the public welfare.

In the event of an emergency suspension, the board would have to provide immediate notice to the license holder stating the grounds for the suspension and holder's right to a hearing. The bill would require a hearing not more than 10 days after the license holder requested one (i.e., not more than five days after issuing notice of a hearing, which could happen no later than five days after receiving a request for hearing).

Penalties. CSHB 1218 would punish intentional fraud in violation of Public Accountancy Act as follows:

- third-degree felony (two to 10 years in prison and an optional fine of up to \$10,000) if it caused a loss of less than \$10,000;
- second-degree felony (two to 20 years in prison and an optional fine of up to \$10,000) if it caused a loss of \$10,000 to \$100,000; and
- first-degree felony (life in prison or a sentence of five to 99 years and an optional fine of up to \$10,000) if it caused a loss of \$100,000 or more.

The bill would grant immunity from criminal liability to a person who acted in good faith voluntarily to assist an investigation of another or who testified or otherwise participated in a proceeding that arose from another's violation.

Administrative. The board would have to report to the governor, lieutenant governor, and the House speaker not later than December 31, 2005, concerning the requirements of the federal Sarbanes-Oxley Act, including any state legislation necessary to conform to its requirements or a forthcoming study by the U.S. General Accounting Office.

The bill also would add standard sunset language governing conflicts of interest, training and removal of a board member, separation of staff and policy functions, information maintenance, equal employment policy, state employee incentive program, and renewal fees for expired licenses.

The bill would take effect September 1, 2003.

**SUPPORTERS
SAY:**

CSHB 1218 would continue the necessary licensing and regulatory functions of the Board of Public Accountancy and equip the board with a potent array of tools and deterrents necessary to help ensure the health of financial markets through vigorous enforcement of the Public Accounting Act. Recent accounting scandals in Texas have disturbed financial markets and surprised unaware and ill-equipped regulators. New enforcement mechanisms and penalties would better enable the board to arrest and deter future abuses by dishonest accountants, whose representations can affect market prices and investment decisions.

Improvements advanced by CSHB 1218 would correspond with a national trend toward strengthening government regulation in the accounting industry. The federal Sarbanes-Oxley Act of 2002 helps safeguard auditor independence across the country but does not relieve states of their duties to improve regulation of CPAs and CPA firms through licensing, investigation, and enforcement.

The state should, however, wait to observe the effects of new federal regulations before enacting any legislation that is substantially similar to existing federal law. Because the prohibitions of the Sarbanes-Oxley Act already restrict accounting firms from offering some 80 percent of the consulting services they formerly provided to audit clients, the incentive for accountants to collude with audit clients and misrepresent audit results has been all but eliminated. In addition, evidence suggests that audit errors are highest during the first three years of a relationship between an accountant

and a client. The state, therefore, should not restrict auditors even more than the Sarbanes-Oxley Act. Instead, the board could adopt more restrictive rules if they became necessary.

The Board of Public Accountancy should continue to stand as an independent agency, especially as it implements the improvements to its structure and operation and new enforcement authority added by HB 1218. The board has a history of self-funded operation that has cost the taxpayer nothing. The bill would enable the board to return even greater value to the state through application of stiffer penalties against violators. Ongoing accounting impropriety deserves the single-minded attention of the board and its staff as they incorporate and exercise new powers the bill would allow. Now is not the time to abolish the board, which is tailored to regulate the increasingly complex work of accountants and their firms.

**OPPONENTS
SAY:**

Because CSHB 1218 would not prohibit auditors from selling consulting services to their clients, the bill would not do enough to prevent accounting scandals similar to Enron and WorldCom. Texas public funds lost over \$300 million due to the demise of these companies. Markets did not reflect their values due to falsities issued by auditors who colluded to gain non-auditing business. To solve this problem, this bill should ban auditors from providing their audit clients any additional services. The governor and financial experts alike recommend this rule, and the federal Sarbanes-Oxley Act holds that states should separately consider their own regulatory schemes.

In addition, this bill should preclude audit teams, not just audit partners, from auditing the same company for more than five consecutive years. All accountants, not only partners, are subject to the incentives that continue to cause audit failures. Any initiative to improve the Public Accounting Act also should call for two-year “cooling off” periods before auditors could be hired by their clients. The Sarbanes-Oxley Act does not extend these levels of protections, and Texas should take the lead.

**OTHER
OPPONENTS
SAY:**

While the functions and duties of the Board of Public Accountancy should be continued, a separate agency does not. The state could realize administrative savings by consolidating this and other professional licensing and regulatory boards under a single agency.

NOTES:

The committee substitute would make only “intentional fraud” a felony under the Public Accounting Act, whereas the bill as introduced would have made any violation of the act a felony. Also, the committee substitute would require a hearing concerning the emergency suspension of a license no more than 10 days after receiving notice of a request for a hearing, while the bill as introduced would have required the scheduling of a hearing “as soon as practicable” after receiving the hearing request.

Legislation enabling the pilot program for the Board of Public Accountancy expires September 1, 2003, and the Sunset Advisory Commission has recommended allowing the program to expire. HB 1 by Heflin, the House-passed version of the general appropriations bill for fiscal 2004-2005, would bring the board back into the budget with total funding of \$5.6 million for fiscal 2004-05.

The Legislative Budget Board in the fiscal note estimates a net gain of \$460,000 to general revenue for fiscal 2004-05 through the collection of administrative penalties authorized by the bill.

The companion bill, SB 274 by Nelson, was referred to the Government Organization Committee on February 27.

HB 2 and HB 3001, both by Swinford, would abolish the Board of Public Accountancy and assign its powers, duties, and assets to a Department of Professional Licensing, which would be created under HB 2489 by Swinford.