

**PRESENTATION OF THE
BOARD OF PUBLIC ACCOUNTANCY**

**TO THE HOUSE COMMITTEE ON
FINANCE**

**TWENTY-EIGHTH LEGISLATURE
Regular Session of 2016**

**Thursday, March 3, 2016
2:00 p.m.**

**TESTIMONY ON HOUSE BILL NO. 1669, H.D. 1, RELATING TO PUBLIC
ACCOUNTANCY.**

**TO THE HONORABLE SYLVIA LUKE, CHAIR,
AND MEMBERS OF THE COMMITTEE:**

My name is Nelson Lau, and I am the Chairperson of the Board of Public Accountancy ("Board"). Thank you for the opportunity to testify on behalf of the Board in strong support of House Bill No. 1669, House Draft 1, Relating to Public Accountancy.

PART I: SECTION 1 and SECTION 2

Peer review in chapter 466, Hawaii Revised Statutes ("HRS") is currently defined as "a study, appraisal, or review of one or more aspects of the professional work of a firm that issues attest reports by a person or persons who hold permits to practice public accountancy under section 466-7 and who are not affiliated with the firm being reviewed". This means that a peer review done by a CPA firm that does not hold a Hawaii firm permit to practice would not be acceptable to the Board in fulfillment of the peer review requirement for the renewal of the reviewed CPA firm's Hawaii firm permit.

However, the Board has found that many Hawaii CPA firms have engaged out-of-State CPA firms as peer reviewers for many years, building a working relationship

and professional rapport with these peer reviewers which results in a quality peer review reflecting the insight and deeper understanding of the firm's professional work that comes from having a long-term affiliation. The Board believes that to now cause these Hawaii CPA firms to abandon these out-of-State peer reviewers would adversely affect our CPA firms. The alternative, which is to cause these out-of-State peer reviewers to obtain licensure in the State of Hawaii, would likely still result in the termination of these long-standing relationships, as such Hawaii licensure may not be in the business plans of these out-of-State CPA peer reviewers. Many times, the peer review may be the only nexus the out-of-State CPA peer reviewer has with Hawaii, with no other CPA engagements that would necessitate Hawaii licensure.

By redefining "peer review" to include peer reviews performed by out-of-State CPAs and CPA firms, Hawaii CPA firms that are required to have peer reviews as a condition of the renewal of their firm permits on December 31, 2017 will be able to continue to have their peer reviews done by their existing out-of-State peer reviewers. In addition, the Board is concerned that there may be an inadequate number of Hawaii peer reviewers to perform the peer reviews that are required; therefore, the amendment to the definition of "peer review" would allow the Hawaii CPA firm the option of engaging the services of a peer reviewer licensed to practice public accounting in another state.

PART I: SECTION 3 and SECTION 4

House Bill No. 1669 House Draft 1, also proposes to increase deadlines for the filing of peer review compliance reporting forms and appealing certain peer review ratings from ten (10) to thirty (30) calendar days. Generally, thirty (30) calendar days is

the customary and accepted time for official notification, as reflected in HRS chapter 436B, the Professional and Vocational Licensing Act. Here, in the "Licensing Model Act", thirty (30) calendar days is the standard time for a licensee to notify the licensing authority of any judgment, award, disciplinary sanction, order, or other determination adjudging the licensee in this State or any other jurisdiction. Thirty (30) calendar days is also the standard time of notice to the licensing authority of any changes to a licensee's mailing, business, or residence address.

The Board believes that the existing ten (10) day notice deadline for submitting a CPA firm's peer review compliance report may be extremely difficult for Hawaii CPA firms to meet. In addition, it was unclear whether the submission deadline was ten (10) calendar or business days. The proposed amendment would clarify that the notice deadline is thirty (30) calendar days from receipt of documentation verifying the completion of a peer review, and would enable Hawaii CPA firms to timely comply.

In addition, the Board believes that increasing the existing deadline to file an appeal to the Board relating to a "pass with deficiency" or a "fail" rating on its peer review from ten (10) to thirty (30) calendar days, would provide adequate time for the CPA firm to appeal to the Board on a matter that may result in a severe sanction such as the denial, termination, or nonrenewal of its firm permit to practice.

PART II: SECTION 5

Section 5 of the bill relates to the Peer Review Oversight Committee ("PROC"), which was established by the Board pursuant to section 466-42, HRS, for the oversight of sponsoring organizations, which are defined as third-party entities that meet the

standards for administering a peer review. As described earlier, a peer review is the appraisal performed by a Certified Public Accountant ("CPA") firm on the professional work of another CPA firm that does attestation services, such as audits, reviews and compilations.

The general purposes of the PROC are to: (1) monitor sponsoring organizations to ensure that peer reviews are being conducted and reported in accordance with standards for performing and reporting on peer reviews adopted by the American Institute of Certified Public Accountants Peer Review Board; (2) review the policies and procedures of sponsoring organization applicants as to their conformity with the peer review standards of any applicable peer review organization and the statutes of the Board; and (3) report to the Board on the conclusions and recommendations reached as a result of performing the functions in (1) and (2) above.

The purpose of this section of the bill is to provide for: (1) the reimbursement for expenses necessary for the performance of the duties of the PROC; and (2) the immunity from any civil liability for any act done in furtherance of the purposes for which the PROC was established.

The PROC consists of three Hawaii-licensed Certified Public Accountants who practice public accountancy in the State of Hawaii. In the performance of their duties, these CPA members of the PROC convene meetings that are subject to HRS chapter 92 (Public Agency Meetings and Records), attend meetings of the Board when necessary, and attend meetings of the sponsoring organizations' peer review committees. The Board believes that the necessary expenses related to these and

other pertinent duties incurred by the PROC members should be reimbursed to the extent that they are related to the purposes of the PROC. The proposed language in this section of the bill is identical to existing language in section 466-15(c), HRS, pertaining to Advisory Committees, which in turn mirrors the provisions relating to advisory committees established by the Department of Commerce and Consumer Affairs ("DCCA") pursuant to section 26-9(s), HRS.

Other duties of the PROC include reviewing and evaluating confidential information concerning specific CPA firms or CPA peer reviewers, and issuing reports to the Board on the continued reliability of sponsoring organizations' peer reviews. The performance of these duties and the importance of the responsibilities in the oversight of the peer review sponsoring organizations and the peer reviewers may subject the PROC and its individual CPA members to civil liability. The possibility of such liability should not impair the judgment of the members of the PROC, nor should it influence the PROC's assessment of the peer review programs. Thus, this section of the bill makes the PROC members immune from civil liability when performing their official duties and responsibilities. The proposed language in this section of the bill is identical to existing language in section 466-15(d), HRS, pertaining to Advisory Committees, which also mirrors the provisions relating to advisory committees established by the DCCA pursuant to section 26-9(s), HRS.

Like members of advisory committees, the members of the PROC serve as volunteers and receive no compensation for the performance of their duties and responsibilities. However, without the amendments proposed in Section 5 of this bill,

PROC members would not be afforded the same considerations as members of an advisory committee in the reimbursement of necessary expenses and in indemnification from civil liability.

PART III: SECTION 6

Pursuant to section 466-32, HRS, a peer review process has been established to review the attest work of CPA firms. Attest work includes: (1) any audit, review, compilation, and any examination of prospective financial information, which are engagements performed in accordance with standards of the American Institute of Certified Public Accountants; (2) any engagement to be performed in accordance with government auditing standards; and (3) any engagement to be performed in accordance with the standards of the Public Company Accounting Oversight Board. Simply put, attestation is the process of independent examination performed by a CPA of the validity of an entity's financial data. This objective evaluation encompasses all research done, including all of the testing and examination of a company's financial data. The goal of an attest function is for the CPA to express an opinion on a company's financial statements and provide some assurance as to their accuracy. As such, it is one of the most important duties of any CPA.

Hawaii CPA firms that perform attest work are required to undergo a peer review every three (3) years. As an integral part of the peer review, the firm's Hawaii offices, if any, and Hawaii attest engagements must be included in the scope of the peer review. Therefore, performance of Hawaii attest work by a CPA firm is the reason these firms must undergo peer review. In fact, the terms "Hawaii attest work" and "Hawaii attest

engagement” are used throughout the statute, appearing nearly twenty (20) times within the sections of the statute relating to peer review. In spite of the term being the actual basis for a firm having to undergo a peer review, the Board has found that many firms are unclear as to what constitutes a Hawaii attest engagement and have appealed to the Board for clarification. This section of the measure proposes to clearly define “Hawaii attest work” to ensure that CPA firms that are required to undergo peer review understand what professional work should be included in the scope of the peer review.

The proposed definition clarifies that the Hawaii attest work is professional work done for clients of a CPA firm who/that are: (1) an individual who is a Hawaii resident; (2) a person, entity, firm, or trust that is domiciled in Hawaii or whose principal or home office is physically located in this State; or (3) a subsidiary that has a physical presence in Hawaii and has a separate, stand-alone financial statement or report issued on that subsidiary.

PROPOSED PART IV: SECTION 7

Lastly, the Board proposes the following amendment to House Bill No. 1669 House Draft 1, to clarify one of the requirements relating to the Hawaii supplement to the peer review report pursuant to section 466-36(a)(2), HRS. This clarification is needed to respond to a number of inquiries received by the Board from CPA firms that are required to undergo an additional review of the CPA firm’s Hawaii attest engagements as a supplement to its overall peer review. When the CPA firm’s overall peer review does not include within its scope the required Hawaii attest engagement, the firm is required to engage the services of a peer reviewer to perform the Hawaii

Testimony on House Bill No. 1669, H.D. 1
Thursday, March 3, 2016
Page 8

supplement. The Board proposes to add the words "one or more" to make clear that the peer reviewer is required to select one or more engagements from the list of engagements obtained from the reviewed firm. This amendment is attached to my testimony for this Committee's consideration.

In closing, the Board strongly supports House Bill No. 1669 House Draft 1, as amended with the Board's suggested changes. A proposed House Draft 2 is attached for your consideration. Thank you for this opportunity to testify. I will be available to answer any questions you may have.

A BILL FOR AN ACT

RELATING TO PUBLIC ACCOUNTANCY.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 PART I

2 SECTION 1. Section 466-3, Hawaii Revised Statutes, is
3 amended by amending the definition of "peer review" to read as
4 follows:

5 ""Peer review" means a study, appraisal, or review of one
6 or more aspects of the professional work of a firm that issues
7 attest reports by a person or persons who hold permits to
8 practice public accountancy under section 466-7 or are licensed
9 to practice public accountancy in any other state and who are
10 not affiliated with the firm being reviewed."

11 SECTION 2. Section 466-35, Hawaii Revised Statutes, is
12 amended by amending subsection (b) to read as follows:

13 "(b) A firm shall include, with the peer review compliance
14 reporting form, the contemporaneous Hawaii supplement to the
15 peer review report pursuant to section 466-36, if:

- 1 (1) A peer review report from an approved sponsoring
- 2 organization does not include the selection of a
- 3 Hawaii office or Hawaii attest engagement;
- 4 (2) The peer reviewer does not hold permits to practice
- 5 public accountancy under section 466-7 [~~and is~~
- 6 ~~required to have permits to practice under section~~
- 7 ~~466-7,~~] or is not licensed to practice public
- 8 accountancy in any other state, except inspectors for
- 9 the public company accounting oversight board; or
- 10 (3) The final report resulting from any inspection by the
- 11 public company accounting oversight board firm
- 12 inspection program does not include the firm's Hawaii
- 13 offices, if any, and Hawaii attest engagements in the
- 14 scope of the inspection, and the firm is not required
- 15 to enroll in another peer review program under section
- 16 466-34."

17 SECTION 3. Section 466-38, Hawaii Revised Statutes, is
 18 amended by amending subsection (b) to read as follows:

- 19 "(b) For peer reviews scheduled after December 31, 2014,
- 20 any report or document required to be submitted under subsection
- 21 (a) shall be filed with the board as follows:

- 1 (1) Firms enrolled in the American Institute of Certified
2 Public Accountants and Hawaii Society of Certified
3 Public Accountants peer review programs and
4 administered by the Hawaii Society of Certified Public
5 Accountants, within [~~ten~~] thirty calendar days of
6 receipt of the notice of completion from the Hawaii
7 Society of Certified Public Accountants, shall
8 complete the peer review compliance reporting form
9 under section 466-35 and submit the form to the board
10 along with the required documents;
- 11 (2) Firms otherwise enrolled in the American Institute of
12 Certified Public Accountants peer review program,
13 including those whose peer reviews are administered by
14 the National Peer Review Committee, within [~~ten~~]
15 thirty calendar days of receipt of the notice of
16 completion from the sponsoring organization, shall
17 complete the peer review compliance reporting form
18 under section 466-35 and submit the form to the board
19 along with the required documents;
- 20 (3) Firms enrolled in the public company accounting
21 oversight board inspection program shall, within [~~ten~~]

1 "[f]§466-42[f] **Peer review oversight committee.** (a) The
2 board shall establish a peer review oversight committee for the
3 purpose of:

4 (1) Monitoring sponsoring organizations to ensure that
5 peer reviews are being conducted and reported in
6 accordance with standards for performing and reporting
7 on peer reviews adopted by the American Institute of
8 Certified Public Accountants Peer Review Board;

9 (2) Reviewing the policies and procedures of sponsoring
10 organization applicants as to their conformity with
11 the peer review standards of any applicable peer
12 review organization and this part; and

13 (3) Reporting to the board on the conclusions and
14 recommendations reached as a result of performing the
15 functions in paragraphs (1) and (2).

16 (b) Except to the extent otherwise required under this
17 section and section 466-41(b), information concerning a specific
18 firm or reviewer obtained by the peer review oversight committee
19 during oversight activities shall be confidential and shall not
20 be subject to discovery, pursuant to section 466-32, and reports
21 submitted to the board by the peer review oversight committee

1 shall not contain information concerning specific firms or
2 reviewers. Members of the peer review oversight committee shall
3 be required to execute confidentiality statements for the
4 sponsoring organization that they oversee.

5 (c) Effective January 1, 2013, the peer review oversight
6 committee shall consist of three individuals who hold permits to
7 practice under section 466-7. No member of the peer review
8 oversight committee shall be a current member of the board, the
9 Hawaii Society of Certified Public Accountants Peer Review or
10 Professional Ethics Committees, or the American Institute of
11 Certified Public Accountants Professional Ethics Executive
12 Committee. The members shall have significant experience with
13 attest engagements and currently be in the practice of public
14 accountancy at the partner or equivalent level. The member's
15 firm shall have received a report with a rating of pass or an
16 unmodified opinion from its last peer review.

17 (d) The peer review oversight committee shall make an
18 annual recommendation to the board as to the qualifications of
19 an approved sponsoring organization to continue as an approved
20 sponsoring organization on the basis of the results of the
21 following procedures:

- 1 (1) Where the sponsoring organization is:
- 2 (A) The American Institute of Certified Public
- 3 Accountants;
- 4 (B) A state certified public accountant society,
- 5 including the Hawaii Society of Certified Public
- 6 Accountants, fully involved in administering the
- 7 American Institute of Certified Public
- 8 Accountants peer review program; or
- 9 (C) The public company accounting oversight board,
- 10 the peer review oversight committee shall review
- 11 the published reports of the entity or the
- 12 entity's successor to determine whether there is
- 13 an acceptable level of oversight; and
- 14 (2) Where the sponsoring organization is other than any
- 15 organization listed in paragraph (1), the peer review
- 16 oversight committee shall perform the following
- 17 functions:
- 18 (A) At least one member of the peer review oversight
- 19 committee shall attend at least one meeting of
- 20 the sponsoring organization's peer review
- 21 committee; and

- 1 (B) During these visits, the peer review oversight
2 committee members shall:
- 3 (i) Meet with the organization's peer review
4 committee during the committee's
5 consideration of peer review documents;
 - 6 (ii) Evaluate the organization's procedures for
7 administering the peer review program;
 - 8 (iii) Examine, on the basis of a random selection,
9 a number of reviews performed by the
10 organization to include, at a minimum, a
11 review of the report on the peer review, the
12 firm's response to the matters discussed,
13 the sponsoring organization's letter of
14 acceptance outlining any additional
15 corrective or monitoring procedures, and the
16 required technical documentation maintained
17 by the sponsoring organization on the
18 selected reviews; and
 - 19 (iv) Expand the examination of peer review
20 documents if significant deficiencies,

1 problems, or inconsistencies are encountered
2 during the analysis of the materials.

3 (e) In the evaluation of policies and procedures of
4 sponsoring organization applicants, the peer review oversight
5 committee shall:

6 (1) Examine the policies as drafted by the applicant to
7 determine whether the policies provide reasonable
8 assurance of conforming to the standards for peer
9 reviews;

10 (2) Evaluate the procedures proposed by the applicant to
11 determine whether:

12 (A) Assigned reviewers are appropriately qualified to
13 perform the review for the specific firm;

14 (B) Reviewers are provided with appropriate
15 materials;

16 (C) The applicant has provided for consultation with
17 the reviewers on problems arising during the
18 review and that specified occurrences requiring
19 consultation are outlined;

20 (D) The applicant has provided for the assessment of
21 the results of the review; and

1 (E) The applicant has provided for an independent
2 report acceptance body that considers and accepts
3 the reports of the review and requires corrective
4 actions by firms with significant deficiencies;
5 and

6 (3) Make recommendations to the board as to approval of
7 the applicant as a sponsoring organization.

8 (f) Annually, the peer review oversight committee shall
9 provide the board with a report on the continued reliability of
10 sponsoring organizations' peer reviews. The peer review
11 oversight committee report shall provide reasonable assurance
12 that peer reviews are being conducted and reported on
13 consistently and in accordance with the Standards for Performing
14 and Reporting on Peer Review adopted by the American Institute
15 of Certified Public Accountants. A summary of oversight visits
16 shall be included with the annual report.

17 (g) The members of the peer review oversight committee
18 shall serve without compensation, but shall be reimbursed for
19 necessary expenses, including travel expenses, that are incurred
20 in the performance of their duties.

Report Title:

Public Accountancy; Peer Review; Peer Review Oversight Committee

Description:

Redefines "peer review" to include reviews done by out-of-state public accountancy licensees. Increases deadlines for filing of peer review compliance reporting forms and appealing certain ratings from 10 days to 30 calendar days. Allows members of the public accountancy peer review oversight committee to be reimbursed for expenses. Protects the members from civil liability for actions done in furtherance of the purposes of the committee. Defines the term "Hawaii attest work". (HB1669 HD1)

The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.



