

**PRESENTATION OF THE
BOARD OF PUBLIC ACCOUNTANCY**

TO THE SENATE COMMITTEE ON
WAYS AND MEANS

TWENTY-EIGHTH LEGISLATURE
Regular Session of 2016

Wednesday, March 30, 2016
9:00 a.m.

WRITTEN TESTIMONY ONLY

**TESTIMONY ON HOUSE BILL NO. 1669, H.D. 2, S.D.1, RELATING TO PUBLIC
ACCOUNTANCY.**

TO THE HONORABLE JILL N. TOKUDA, CHAIR,
AND MEMBERS OF THE COMMITTEE:

My name is Nelson Lau, and I am the Chairperson of the Board of Public Accountancy ("Board"). The Board appreciates the opportunity to submit written testimony in strong support of House Bill No. 1669, H.D. 2, S.D. 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 Certified Public Accountant ("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 Hawaii CPA firms the option of engaging the services of a peer reviewer licensed to practice public accounting in another state.

PART I: SECTION 3

House Bill No. 1669, H.D. 2, S.D. 1, also proposes to clarify one of the requirements relating to the Hawaii supplement to the peer review report pursuant to section 466-36(a)(2), HRS, by adding the phrase “one or more” 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 supplement. The additional language makes it clear that the peer review is required to select one or more engagements from the list of engagements obtained from the reviewed firm.

PART I: SECTION 4 and SECTION 5

Sections 4 and 5 of the bill 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 6

Section 6 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 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 purposes of this section of the bill are 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 CPAs 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 7

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.

In closing, the Board strongly supports House Bill No. 1669, H.D. 2, S.D. 1, and respectfully requests the Committee's favorable consideration.

Thank you for the opportunity to submit written testimony on House Bill No. 1669, H.D. 2, S.D. 1.