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REVISE CPA REQUIREMENTS

House Bill 4238 as enrolled
Public Act 10 of 1997
Sponsor: Rep. Barbara Dobb

House Committee: Regulatory Affairs
Senate Committee: Economic Development,
International Trade, and Regulatory
Affairs

Second Analysis (8-21-97)

THE APPARENT PROBLEM:

Recent years have seen many changes in the profession of public accountancy. Certified public accountants (CPAs) differ from other accountants in educational requirements, passing a stringent national examination, and state licensure. The primary function of CPAs is to provide "attest" functions, which consist of audits, reviews, and compilations, so as to assure the user of a document that the information contained in it is presented fairly and accurately. As the business community continues to evolve into a global market, CPA firms and individual CPAs are increasingly doing inter-state and trans-continental business. Also, many firms and individuals are expanding their services to include diversified financial services for such things as estate planning, personal financial planning, and succession planning (transferring a business to a family member). In addition, the American Institute of Certified Public Accountants (AICPA) recently dropped its ban on CPAs accepting contingency fees and commissions for non-attest functions in response to a Federal Trade Commission suit charging that the ban constituted a restraint of trade. However, current Michigan law regulating CPAs and CPA firms has not kept up with the changing nature of the profession. In an attempt to address these concerns, and to bring the provisions pertaining to CPAs up to date with the rest of the Occupational Code, legislation has been proposed that would recodify Article 7 (public accounting) and incorporate certain provisions of the Uniform Accountancy Act, a model act developed by AICPA and the National Association of State Boards of Accountancy (NASBA).

THE CONTENT OF THE BILL:

House Bill 4238 would repeal and replace provisions in the Occupational Code (MCL 339.701 to 339.716) regulating certified public accountants to, among other things, include a definition of certified public accountant

(CPA); permit a licensed CPA to receive contingent fees and commissions under certain circumstances; require both individuals and firms engaging in the practice of public accounting to be licensed (persons intending only to use a title or designation of CPA would have to be registered with the Department of Consumer and Industry Services). The bill would delete, among other things, the current residency requirement to sit for the CPA exam, the requirement that qualifying experience be completed within the six-year period preceding examination for certification as a CPA, the biennial publication of a register containing a list of registered CPAs and firms of CPAs in the state, the position of executive secretary to the Board of Accountancy, and the Administrative Committee on Public Accountancy within the Department of Consumer and Industry Services. (Note: Executive Order 1996-2 renamed the Department of Commerce as the Department of Consumer and Industry Services and transferred the functions of the Administrative Committee on Public Accountancy to the director of the Department of Consumer and Industry Services.)

Many of the provisions of the bill are substantially the same as existing law. The substantive changes are summarized below:

Definitions. "Certified public accountant" would mean an individual who was qualified by education, examination, and experience; and held a certificate as a certified public accountant under provisions of the bill to engage or offer to engage in the practice of public accounting.

"Firm" would mean a corporation, partnership, limited liability company, unincorporated association, sole proprietorship operating under an assumed name, or other legal entity.

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"Practice of public accounting" would mean, in addition to the current definition under the code, offering to render an opinion on or offering to attest to the reliability of a representation or estimate as to the accuracy of financial information being audited or reviewed. Additionally, the bill would specify that the practice of public accounting would include one or more of the following activities when performed or offered to be performed by a person holding himself or herself out as a CPA:

- * The issuance of reports on financial statements.
- * One or more kinds of management advisory, financial advisory, or consulting services.
- * The preparation of tax returns.
- * The furnishing of advice on tax matters.

CPA Certification. In addition to current requirements under the code, the bill would require that an applicant for a certificate as a CPA have two years of qualifying experience under the direction and supervision of a licensed CPA in either of the following:

1) The practice of public accounting with experience obtained in one financial audit and in all of the following areas (which could be performed under the direction and supervision of a licensed CPA during the course of an applicant's undergraduate studies):

--The application of auditing procedures and techniques to the usual and customary financial transactions recorded in accounting records.

--The preparation of working papers that cover examination of accounts found in accounting records for audit, review, and compilation.

--The participation in planning a program of work, including the selection of the procedures to be followed, for audit, review, and compilation.

--The participation in the preparation of reports, including written explanations and comments on the findings of the examinations and the content of the accounting records.

--The participation in the preparation and analysis of financial statements together with explanations and notes.

The financial audit requirement could be satisfied by an audit performed under the direction and supervision of a licensed CPA who was not the applicant's employer or by an audit performed as part of the applicant's undergraduate studies.

2) The practice of public accounting with a governmental agency as currently provided under the code.

A firm organized to practice public accounting would have to be licensed and would have to provide a change in address to the department within 30 days of the

The bill would delete a provision pertaining to reviewing a financial statement and supporting material that covers the financial condition and operations of entities engaged in three or more distinct lines of commercial or industrial business. The bill would also specify that auditing standards could be in accordance with generally accepted auditing standards or generally accepted government auditing standards.

Currently, individuals certified as CPAs from other states or foreign countries meeting similar qualification standards are issued certificates as CPAs for Michigan. The bill would expand those eligible under this provision to those certified under the authority of a country under U.S. jurisdiction. For those with certification from a country outside of U.S. jurisdiction, the bill would require that the individual also pass a board-approved examination on topics specific to the practice of public accounting in the U.S.

Temporary permit to practice. Current law permits a CPA of another state or foreign country to temporarily engage in the practice of public accounting in this state if he or she meets certain criteria. The bill would change one of the criteria from requiring the individual to secure permission from the board of accountancy to conduct the temporary practice to require instead that the CPA secure a temporary permit from the department to conduct the practice in the state. Also, the bill would specify that the temporary practice be conducted in conformity with a new provision pertaining to financial audits on domestic insurers and applicable rules.

Licensure. Currently, each individual certified as a CPA, or firm or corporation organized for the practice of public accounting, must be registered with the Department of Consumer and Industry Services. A person is prohibited from holding himself or herself out as a CPA or practicing public accounting unless licensed by the department. The bill would instead require an individual seeking to use a title authorized under the Occupational Code and engaging in the practice of public accounting to be licensed. A person wishing only to use the title would have to apply to be registered with the department. Further, the bill would specify that in order to renew an individual license, a licensee would have to complete at least 40 hours of continuing education for each year since the issuance of the original license or the last renewal. At least eight of the forty credit hours would have to be in the areas of auditing and accounting.

change. In addition, at least two-thirds of the equity and voting rights of a firm would have to be held (directly or beneficially) by individuals who were licensed in good standing as CPAs of this or another state or licensing jurisdiction acceptable to the board, and the principal officer and each officer or director having authority for the practice of public accounting by the firm would have to be licensed in good standing as a CPA in this or another state or an approved licensing jurisdiction.

Contingent fees. A "contingent fee" would mean a fee established for the performance of a service pursuant to an arrangement in which no fee would be charged unless a specified finding or result was attained or in an arrangement where the amount of the fee was dependent upon a finding or result of the service. A contingent fee would not include a fee fixed by a court or other public authority and, in tax matters, a fee determined based upon the results of judicial proceedings or the findings of a governmental agency.

The bill would permit a CPA to charge or receive a contingent fee. However, a licensee under the code could not charge or receive a contingent fee from a client for the preparation of an original or amended tax return or claim for a tax refund, or during the period that a licensee or a licensee's firm was engaged to perform for the client one or more of the following services or during the period of time covered by any of the client's historical financial statements involved in those services:

- * An audit or review of a financial statement.
- * A compilation of a financial statement when the licensee expects, or could reasonably expect, that a third party would use the financial statement and that the compilation report did not disclose a lack of independence.
- * An examination of prospective financial information.

Commissions. The bill would permit CPAs to perform services for a commission, or receive a commission for services performed. However, the CPA would have to disclose the arrangement to the person to whom the CPA recommends or refers a product or service to which the commission relates. A licensee would not be prohibited from paying or receiving a referral fee for recommending or referring a service involving the practice of public accounting if the payment or receipt of the referral fee was disclosed to the client. A licensee would be prohibited from receiving a commission for recommending or referring a product or service to a client or for causing to be recommended, referred, or supplied to a client a product or service during the period

in which a licensee or his or her firm was engaged by the client to perform one or more of the following services or during the period of time covered by any historical financial statements involved in those services:

*An audit or review of a financial statement.

*A compilation of a financial statement when the licensee expects, or could reasonably expect, that a third party would use the financial statement and that the compilation report did not disclose a lack of independence.

*An examination of prospective financial information.

Penalties. The bill would add to the list of actions subject to penalties under the code (MCL 339.602) a violation of professional standards regarding the issuance of reports on financial statements; one or more kinds of management advisory, financial advisory, or consulting services; the preparation of tax returns; or the furnishing of advice on tax matters. The bill would also specify that a violation of this article or a rule promulgated under this article would be subject to the penalties under the code which includes a civil fine of up to \$10,000 to be paid to the department. The bill would retain the current provision that a person or firm who engages in the practice of public accounting without a license or who unlawfully uses the title of CPA is guilty of a misdemeanor punishable by a fine of not more than \$5,000 or imprisonment of not more than one year, or both.

Administrative rules. Current rules prohibiting contingency fees and commissions would have to be rescinded, and rules pertaining to continuing education credits would have to be modified to conform with the bill. The code currently requires the Board of Accountancy to promulgate rules to address certain concerns. Under the bill, rule promulgation would be allowed, rather than required, and would be the responsibility of the director of the Department of Consumer and Industry Services to conform with Executive Order 1996 - 2, which transferred rule making authority from the Board of Accountancy to the director of the department.

Miscellaneous provisions. If requested by an insurer, a licensee who agreed to issue an audit report concerning the statutory financial statements of a domestic insurer would have to include an opinion as to whether the financial information was presented according to statutory accounting principles under the Insurance Code (MCL 500.1 et al.) or orders issued or rules promulgated under the code. If the letter of engagement provided that the opinion be available for general distribution, the opinion could be separate from the audit report.

BACKGROUND INFORMATION:

House Bill 4238 is nearly identical to legislation introduced in the 1995-96 legislative session (House Bill 5717). That bill passed the House and Senate but was not ordered enrolled.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, eliminating the requirement to publish a directory of licensed individuals and firms would save the Department of Consumer and Industry Services approximately \$5,750. Further savings could be realized in time through new efficiencies in the administration of tests and of other provisions of the Occupational Code which would be updated by the bill. (8-11-97)

ARGUMENTS:

For:

According to the Bureau of Occupational and Professional Regulation within the Dept of Consumer and Industry Services, the bill would bring Article 7 of the Occupational Code into conformity with the rest of the code. For example, current law requires certified public accountants (CPAs) and CPA firms to be registered with the state. Individual CPAs must then be licensed before performing attest functions. The bill would instead license both individuals and CPA firms, which is in line with the rest of the code. Registration of a CPA certificate would be reserved for those individuals wishing to use the title of CPA but not intending to do attest functions.

Secondly, current language in the article requires the CPA exam to be written, which prohibits the use of computerized testing and scoring procedures which are used in a number of graduate and professional examinations.

Third, current law requires all owners of a CPA firm to be licensed CPAs, even though not all of the partners perform attest functions such as doing audits. The bill would allow for non-CPA ownership, as long as the majority of the owners, principal officers, and those with authority for the practice of public accounting were licensed as CPAs. This is very practical in light of the recent national trend for CPA firms to offer diversified financial services, such as estate planning.

Another significant change would be to require only eight of the 40 yearly continuing education credits to be in auditing and accounting procedures. In this way, since not all CPAs do public accounting, a CPA would be able

to choose conferences and seminars better suited to his or her specific job duties.

Further, removing the residency requirement to sit for the CPA exam conforms to provisions in the North American Free Trade Agreement (NAFTA) that allows residents of Canada to take exams given in the U.S.

For:

In response to a Federal Trade Commission lawsuit charging that prohibiting CPAs from receiving commissions and contingency fees constituted unfair trade practices, the American Institute of Certified Public Accountants (AICPA) has dropped its ban on CPAs receiving these fees under certain conditions. The bill would adopt many of the guidelines regarding contingency fees and commissions contained within the Uniform Accountancy Act, a model act developed by AICPA and the National Association of State Boards of Accountancy (NASBA).

House Bill 4238 would allow a CPA to accept either contingency fees (a fee that would be paid based on an outcome; for example, a fee for selling a business would only be paid if the business was sold) or commissions (recommending or referring a product or service, such as a software program). However, in the case of commissions, a CPA would have to disclose the nature of the commission to the client. Also, a CPA would be prohibited from receiving either contingency fees or commissions during the period in which an attest function -- audit, review, and/or compilation -- was being performed. In addition, the AICPA has additional interpretations and rulings to offer as guidelines for CPAs to follow to protect their integrity in regards to receiving contingency fees and commissions. According to a representative of the Michigan Association of Certified Public Accountants (MACPA), it is expected that CPAs would strive to protect their integrity and independence, and to not give even the appearance of impropriety since that could compromise the perception of their ability to perform an unbiased and independent audit.

Against:

The main thrust of the Uniform Accountancy Act (the model act developed by the AICPA) was to increase the required college education from 120 semester hours, which is the basic requirement for a bachelor's degree, to 150 credit hours. Yet this proposal, unlike an earlier version, would not do that. Under the model act, the additional 30 credit hours would have to be completed before a person could sit for the CPA exam, and these additional hours would not have to be in the area of accounting. Apparently, mistakes have been made by CPAs as a consequence of not having a broad base of knowledge regarding cultural differences, historical

events, management techniques, and even basic psychology in dealing successfully with others. It is widely believed that requiring more credits in the liberal arts will produce professionals who are well-rounded and better prepared to meet the many needs of their clients. In fact, over 30 states have adopted the 150-hour requirement, most which will begin in the year 2000.

~~This analysis was prepared by non-staff business members in their deliberations, and does not constitute an official s~~

With the majority of states about to implement this change in educational requirements, some are concerned that if Michigan does not increase its educational requirement to 150 hours, Michigan CPAs and Michigan universities and colleges will be disadvantaged. Currently, CPAs enjoy reciprocity, or the ability to practice under certain conditions in a state other than the one they were licensed in. As more and more states implement the 150-hour law, as it called, many fear that a Michigan-licensed CPA would not be as attractive an employee to a company that does business across state lines if the CPA would not receive reciprocity due to differing educational standards. In addition, Michigan colleges and universities would have a harder time attracting out-of-state accounting students if their bachelor's degree would not permit them to sit for the CPA exam in their home state.

Response:

It is a myth that uniform CPA reciprocity exists between the states now. According to information gathered by CARECPA, the Coalition Against Restrictive Entry into the CPA Profession, over 54 variations of states' accountancy laws exist now. Educational requirements range from no college required to two years, four years, 150 hours, or a masters degree. Accounting unit requirements have 13 versions ranging from 0 units to 30 units. Experience required for sitting for the CPA exam and licensure range from zero to six years and zero to eight years depending on education, respectively. To counter the current differences, most states have adopted what is referred to as the "5/10 rule," or some variation of it. This would mean that a licensed CPA in good standing for at least five out of the last ten years would be eligible for reciprocity. Reportedly, approximately 30 states offer reciprocity under the 5/10 rule. The 150-hour law would not be the answer to reciprocity, and it could prove to be a financial hardship to many students.

Moreover, though this has been a point of contention, reportedly the interested parties have agreed to proceed with this legislation, and to deal with the 150-hour issue at a later date.

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