

**DEPARTMENT OF CONSUMER AFFAIRS
TITLE 16. PROFESSIONAL AND VOCATIONAL REGULATIONS
DIVISION 1. CALIFORNIA BOARD OF ACCOUNTANCY**

INITIAL STATEMENT OF REASONS

Hearing Date

Wednesday, February 26, 2025

Subject Matter of Proposed Regulations

Firm Responsibilities for Peer Review; Attest Engagement Notification

Section(s) Affected

Title 16, California Code of Regulations (CCR), Division 1 sections 41 and 50.1

Background and Statement of the Problem:

The California Board of Accountancy (CBA or Board) is a board within the Department of Consumer Affairs (DCA) responsible for regulating the practice of public accounting in the State. Pursuant to Business and Professions Code (BPC) section 5000.1, the protection of the public is the CBA's highest priority in exercising its licensing, regulatory and disciplinary authority. BPC section 5010 authorizes the CBA to adopt, repeal or amend regulations as may be reasonably necessary and expedient for the orderly conduct of the CBA's affairs and for the administration of the Accountancy Act.

Since 2019, the CBA has been discussing the topic of accounting firms providing attest services when the firm's ownership is comprised solely of Certified Public Accountants (CPAs) who have not completed the attest experience requirement and are therefore not authorized to sign reports on attest engagements.

In California, applicants for CPA licensure must complete a minimum of one year of general experience, performed in accordance with applicable professional standards, which may include providing any type of service or advice involving the use of accounting, attest, compilation, management advisory, financial advisory, tax, or consulting skills. Licensees who have met the general experience requirement can perform a wide range of accounting services, but are not authorized to sign reports on attest engagements.

For CPAs that want to sign reports on attest engagements, BPC section 5095 requires CPAs complete a minimum of 500 hours of experience, to the satisfaction of the CBA, in attest services. This experience requirement is detailed further in 16 CCR section 12.5. Attest services include an audit, a review of financial statements, or an examination of prospective financial information, per 16 CCR section 2.4.

While the CBA does have an experience requirement that determines the level of service that CPAs may perform, such a requirement does not extend to accounting firms. As the CBA does not issue licenses to accounting firms based on general or attest experience, there is no prohibition against these accounting firms performing attest work. In fact, the CBA adopted a regulation that allows for this to occur.

16 CCR section 50.1 – Attest Client Notification Regarding Composition of Firm Ownership – states:

Any licensee employed by a firm in which no licensee owners are authorized to sign reports on attest engagements pursuant to Business and Professions Code Section 5095 must, prior to engaging in attest services, provide written notification to any attest client or prospective attest client of the ownership composition of the firm. Notice shall be provided by any of the following methods:

- (a) Providing a statement to the attest client or prospective attest client to be signed and dated by the client and retained in the client's records, which states the client or prospective client understands that no firm owners are authorized to sign reports on attest engagements.
- (b) Posting a written notice on the firm's Internet Web site, disclosing all owner's names and whether each is authorized to sign reports on attest engagements pursuant to Business and Professions Code Section 5095.

Therefore, licensees that have only completed general accounting experience and who are not authorized to sign reports on attest engagements can be an owner (even a sole owner), of an accounting firm that offers full-service accounting, including attest services.

Over the course of several discussions, and in an effort to increase consumer protection, in January 2020, the CBA adopted various Committee on Professional Conduct (CPC) recommendations regarding firms providing attest services when the licensee owners have not completed the attest experience requirement (*see Underlying Data, item numbers 4-6*). Two of these recommendations would require regulatory changes and are noted below.

1. Require accounting firms to disclose to their peer reviewers that no owner is authorized to sign reports on attest engagements.
2. Require accounting firms to include in their engagement letters for attest services a notification to the client of the name and license number of the CPA that the firm has authorized to sign the attest report on behalf of the accounting firm.

At its September 2021 meeting, the CBA took steps to initiate regulatory changes to set in motion modifications to address these items, and the CBA adopted proposed regulatory text for 16 CCR sections 41 and 50.1 (*see Underlying Data, item numbers 7-9*).

However, due to other issues identified regarding the attest and general experience requirements, the CBA paused efforts to complete these actions, and established the Consideration of the CPA Experience Requirements Taskforce (CERT) to study the necessity and sufficiency of the attest experience requirement.

With CERT having recommended that the current attest experience requirement is necessary and sufficient for the protection of consumers, and with the CBA having accepted those recommendations, CERT affirmed at its January 2023 meeting that the actions taken by the CBA to increase consumer protection surrounding this issue appear sufficient. Therefore, staff resumed efforts to complete the actions recommended by the CPC in January 2020.

In March 2023, staff presented the proposed regulatory text for 16 CCR sections 41 and 50.1, for reauthorization to initiate the rulemaking process. Although there were no changes to the previously proposed regulatory text that was adopted in September 2021, in an effort to adhere to DCA's new guidelines on motion language, staff presented the proposed regulatory text for re-approval. The CBA adopted the proposed regulatory text for 16 CCR sections 41 and 50.1, and directed staff to take all steps necessary to initiate the rulemaking process (*see Underlying Data, item number 10*).

Problem Agency Intends to Address

As discussed in the introduction, while the CBA does have an experience requirement that determines the level of service that CPAs may perform, such a requirement does not extend to accounting firms. As the CBA does not issue licenses to accounting firms based on general or attest experience, there is no prohibition against these accounting firms performing attest work. In fact, 16 CCR section 50.1 allows for this to occur.

Therefore, licensees that have only completed general accounting experience and who are not authorized to sign reports on attest engagements can be an owner (even a sole owner), of an accounting firm that offers full-service accounting, including attest services.

This regulatory proposal will provide enhanced consumer protection in such circumstances, through peer review notification and enhanced client notification, as detailed below.

Peer Review Notification

Accounting firms that perform accounting and auditing services (which includes attest services) must complete a peer review once every three years (BPC section 5076, and 16 CCR section 40). Accounting firms are responsible for compliance with the peer review requirement (16 CCR section 41). As part of the peer review, the peer reviewer will take a cross-section of accounting and auditing work performed by the accounting firm, including work performed by all signers of the reports (16 CCR sections 48(d)(1)(A) and (d)(2)(A)).

The proposed amendments would require an accounting firm, where the ownership of the firm is comprised solely of licensees who are not authorized to sign reports on attest engagements, to provide written notice to the peer reviewer or peer review team that the firm has no owner authorized to sign reports on attest engagements.

Presently, accounting firms are not required to notify the peer reviewer or peer review team that the firm has no owner authorized to sign reports on attest engagements. The American Institute of Certified Public Accountants (AICPA) operates a national peer review program, and California is unique in requiring specific experience to sign reports on attest engagements. As such, the AICPA program does not contemplate the need to obtain this information. The CBA believes that a peer reviewer should be made aware of the firm structure in these cases, as it is a risk factor they should consider.

While a firm is not limited in the services it can render, if the ownership of that firm has not obtained the necessary experience to allow for them to sign reports on attest engagements, they must appoint a licensee who has the required experience, to sign on behalf of the firm. The owner is responsible for ensuring the quality control system of the firm, yet they may not have the necessary experience to properly design said system as they are not authorized to sign reports on attest engagements. This presents a risk factor peer reviewers should be knowledgeable about in considering the totality of the peer review.

Currently, obtaining this information is not a part of a peer reviewer's process, so they will need to be notified. Rather than put the burden on the peer reviewer to ask this of all reviews done, the CBA determined it is better to require the firm to notify the peer reviewer.

Enhanced Client Notification

16 CCR section 50.1 requires notification to the client regarding the fact that the owners of the accounting firm are not authorized to sign reports on attest engagements. Accounting firms must comply with this prior to engaging in these services.

Presently, accounting firms can accomplish this in one of two ways:

1. Through written notification signed and dated by the client or prospective client and retained in the client's records, which states that the client or prospective client understands that no owners are authorized to sign reports on attest engagements; or
2. Posting a written notice on the accounting firm's website disclosing the owners' names and whether each is authorized to sign reports on attest engagements.

The proposed amendment would require the accounting firm to provide the client or prospective attest client with the name and license number of the licensee the firm has authorized and designated to sign the report on attest engagement on behalf of the firm, and would eliminate the option to post a written notice on the accounting firm's website.

This regulatory proposal enhances consumer protection by ensuring the client receives more direct notification, and is provided with all the information necessary to make a fully informed decision to have the accounting firm perform the attest services. Eliminating the option to post a written notice on the accounting firm's website ensures the client is directly made aware of the ownership composition of the firm, rather than expecting the client to locate that information themselves on the firm's website.

Benefits Anticipated from Regulatory Action

This regulatory proposal would establish requirements for licensees to follow in circumstances where an accounting firm is providing attest services when the ownership of that firm is comprised solely of licensees who do not have the authority to sign reports on attest engagements.

For the reasons stated above in the Peer Review Notification section under Problem Agency Intends to Address, this regulatory proposal is anticipated to increase transparency in regard to the peer review process, by ensuring peer reviewers are aware of the circumstance, prior to commencement of the peer review, that no owner is authorized to sign reports on attest engagements, and that some of the work being reviewed may include reports signed by individuals no longer working for the accounting firm.

Additionally, this regulatory proposal is anticipated to increase consumer protection by providing consumers with valuable information that will allow them to perform a search on the CBA website to ensure licensees signing reports on attest engagements have completed the necessary attest experience, and to determine whether the CBA has taken any discipline or other enforcement action against the licensee. The proposed amendments will also allow for a more direct notification to clients, further enhancing consumer protection.

Specific Purpose/Factual Basis/Rationale

1. Amend CCR Section 41 (Firm Responsibilities)

The proposed amendments would establish the requirement for firms providing attest services, where the ownership of the firm is comprised solely of licensees who are not authorized to sign reports on attest engagements, to provide, prior to the commencement of the peer review, written notice to the peer reviewer or peer review team that the firm has no owner authorized to sign reports on attest engagements.

Section 41

The CBA proposes to add subdivision (a), to indicate the creation of subdivisions for this regulation. This amendment is necessary to specify which subdivision of the CCR section is being referenced. Through this rulemaking, a subdivision (b) is being added, covering a related subject matter the Board has determined distinct enough to necessitate a separate subdivision.

Section 41(b)

The CBA proposes to add the following language:

(b) For a firm that issued reports on attest engagements as defined by Article 1, Section 2.4, and where the ownership of the firm is comprised solely of licensees who are not authorized to sign reports on attest engagements pursuant to Business and Professions Code section 5095, prior to the commencement of the peer review, the firm shall provide written notice to the Peer Reviewer or Peer Review Team that the firm has no owner authorized to sign reports on attest engagements.

Rationale: The proposed amendments are necessary to increase transparency and ensure peer reviewers are aware of the circumstance, prior to commencement of the peer review, that no owner is authorized to sign reports on attest engagements (as defined in 16 CCR section 2.4, which is addressed in the introduction), and that some of the work being reviewed may include reports signed by individuals no longer working for the accounting firm.

The proposed amendments articulate which group of people this subdivision applies to, and require notification prior to the commencement of the peer review, as this is information peer reviewers should be knowledgeable about before reviewing any work.

As explained in the Peer Review Notification section under Problem Agency Intends to Address, while a firm is not limited in the services it can render, if the ownership of that firm has not obtained the necessary experience to allow for them to sign reports on attest engagements, they must appoint a licensee who has the required experience, to sign on behalf of the firm. The owner is responsible for ensuring the quality control system of the firm, yet they may not have the necessary experience to properly design said system as they are not authorized to sign reports on attest engagements. This presents a risk factor peer reviewers should be knowledgeable about in considering the totality of the peer review.

Section 41 Note

The CBA proposes to revise the Reference section to add “s” after section and “and 5095”. These amendments are necessary to promote accuracy and clarity for the reader and to include BPC section 5095, which describes the licensees who are authorized to sign reports on attest engagements.

2. Amend CCR Section 50.1 (Attest Client Notification Regarding Composition of Firm Ownership)

The proposed amendments would require that accounting firms providing attest services where the ownership of the firm is comprised solely of licensees who are not authorized to sign reports on attest engagements, prior to engaging in attest services, provide notification to the client of the name and license number of the CPA that the firm has authorized to sign the attest report on behalf of the accounting firm. The proposed

amendments would also amend this section to remove the website posting notification method.

Section 50.1

The CBA proposes to amend this section relating to attest client notification requirements for licensees employed by a firm in which no licensee owners are authorized to sign reports on attest engagements.

- a. Add “The” and amend “Notice” as “notice”.

Rationale: The CBA proposes to amend this section to require a more direct notification to clients, and therefore proposes to change the general use of the word “Notice” to something more specific - “The notice”. The CBA anticipates the notification will most likely be accomplished through an engagement letter; however, the proposed amendments provide flexibility. These amendments are necessary to ensure the client receives a more direct notification, further enhancing consumer protection.

- b. Replace “be provided by any of the following methods: (a) Providing” with “include”, and delete “to the attest client or prospective attest client”.

Rationale: The CBA proposes to amend this section to require a more direct notification to clients, and therefore proposes to remove the language that suggests multiple methods of notification are allowed. These amendments are necessary to ensure the client receives a more direct notification, further enhancing consumer protection. The CBA also proposes to delete “to the attest client or prospective attest client”. This amendment is necessary to improve readability, as the sentence would be redundant otherwise, because earlier text in the existing subdivision already requires the notice be made “to any attest client or prospective attest client.”

- c. Add “and the name and license number of the licensee the firm has authorized and designated to sign the report on attest engagement on behalf of the firm”

Rationale: The CBA proposes to amend this section to require that accounting firms providing attest services where the ownership of the firm is comprised solely of licensees who are not authorized to sign reports on attest engagements, include a notification to the client of the name and license number of the CPA that the firm has authorized to sign the attest report on behalf of the accounting firm.

This is necessary to provide the client with valuable information that allows the client to perform a search on the CBA website to ensure the licensee has completed the necessary attest experience and determine whether the CBA has taken any discipline or other enforcement action against the licensee.

- d. Delete existing subdivision (b).

Rationale: The CBA proposes to amend this section to remove the website posting notification method. By eliminating the website notice method, notice may only be made by direct contact with the attest client or prospective attest client. This is necessary to ensure that consumers receive a more direct notification, further enhancing consumer protection. As explained in the Enhanced Client Notification section under Problem Agency Intends to Address, eliminating the option to post a written notice on the accounting firm's website ensures the client is directly made aware of the ownership composition of the firm, rather than expecting the client to locate that information themselves on the firm's website.

Underlying Data

Technical, theoretical, or empirical studies, reports, or documents relied upon:

1. July 25, 2019, EPOC Item II. and CBA Item X.B.2. – Discussion and Possible Action Regarding Licensees Who Completed the General Experience Requirement Providing Attestation-Related Services and Associated Enforcement Activities
2. Minutes of the July 25, 2019 CBA's Enforcement Program Oversight Committee EPOC Meeting
3. Minutes of the July 25, 2019 CBA Meeting
4. January 16, 2020, CPC Item III. and CBA Item XII.A.3. – Discussion and Possible Action Regarding Accounting Firms Providing Attest Services with Ownership Comprised Solely of Certified Public Accountants Who Have Not Completed the Attest Experience Requirement
5. Minutes of the January 16, 2020 CBA's CPC Meeting
6. Minutes of the January 16, 2020 CBA Meeting
7. September 23-24, 2021, CPC Item III. and CBA Item XVI.A.2. – Discussion and Possible Action to Initiate a Rulemaking to Title 16, California Code of Regulation Section 41 – Firm Responsibilities and Section 50.1 – Client Notification, Regarding Accounting Firms Providing Attest Services With Ownership Comprised Solely of Certified Public Accountants Who Have Not Completed the Attest Experience Requirement
8. Minutes of the September 23, 2021 CBA's CPC Meeting
9. Minutes of the September 23-24, 2021 CBA Meeting
10. March 23-24, 2023, CPC Item III. and CBA Item XVI.B.2. – Discussion and Possible Action to Consider Changes to Previously Proposed Text and Reauthorization of a Regular Rulemaking to Amend California Code of Regulations, Title 16, Section 41 – Firm Responsibilities and Section 50.1 – Client Notification, Regarding Accounting Firms Providing Attest Services With Ownership Comprised Solely of Certified Public Accountants Who Have Not Completed the Attest Experience Requirement

Business Impact

The CBA has made an initial determination that the proposed regulations will not have a significant statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

This initial determination is based on the following facts/evidence/documents/testimony or other evidence:

- The proposal requires accounting firms, where the ownership of the firm is comprised solely of licensees who are not authorized to sign reports on attest engagements, to include an additional statement in their current written disclosure to peer reviewers. This requirement can be completed with normal business operations and is not anticipated to result in additional costs.
- Presently, the CBA requires licensees employed by firms in which no licensee owners are authorized to sign reports on attest engagements, to provide written notification to attest clients and prospective attest clients of the ownership composition of the firm. This proposal requires those licensees to include in that current notification the name and license number of the licensee the firm has authorized and designated to sign the report on attest engagement on behalf of the firm. This requirement can be completed with normal business operations and is not anticipated to result in additional costs.

Economic Impact Assessment

This California Board of Accountancy has determined that this regulatory proposal will have the following effects:

- It will not create nor eliminate jobs within the State of California because it only requires an additional statement in a firm's written disclosure to peer reviewers and an inclusion in a firm's engagement letters.
- It will not create new businesses or eliminate existing businesses within the State of California because it would only require an additional statement in a firm's written disclosure to peer reviewers and an inclusion in a firm's engagement letters.
- It will not affect the expansion of businesses currently doing business within the State of California because it would only require an additional statement in a firm's written disclosure to peer reviewers and an inclusion in a firm's engagement letters.
- This regulatory proposal benefits the health and welfare of California residents because the proposal would allow the CBA to better protect consumers by

adding additional requirements for licensees to follow in circumstances where an accounting firm is providing attest services when the ownership of that firm is comprised solely of licensees who have not completed the attest experience requirement, and are therefore not authorized to sign reports on attest engagements.

- This regulatory proposal does not affect worker safety because it has nothing to do with worker safety.
- This regulatory proposal does not affect the state’s environment because it has nothing to do with the environment.

Specific Technologies or Equipment

This regulation does not mandate the use of specific technologies or equipment.

Consideration of Alternatives

Reasonable Alternatives Considered or Agency’s Reasons for Rejecting Those Alternatives – Gov. Code Section 11346.2(b)(4)(A):

No reasonable alternative to the regulatory proposal would be either more effective in carrying out the purpose for which the action is proposed or would be as effective or less burdensome to affected private persons and equally effective in achieving the purposes of the regulation in a manner that ensures full compliance with the law being implemented or made specific. Further, there is no adverse impact on small businesses; for this reason, no description of reasonable alternatives to such impacts are discussed.

Set forth below is the alternative considered and the reason the alternative was rejected:

- The alternative considered was to maintain the status quo. The CBA rejected this alternative because currently, peer reviewers may be unaware of the circumstances surrounding the ownership composition of the firm for which they are conducting a peer review, and the CBA believes they should be made aware of the fact that no owners are authorized to sign reports on attest engagements, for purposes of full disclosure and transparency. Additionally, if these amendments are not adopted, consumers will continue to be underinformed about the qualifications and/or potential disciplinary history of the licensees performing attestation services for them.

Analysis of Whether the Regulations are an Efficient and Effective Means of Implementing the Law in the Least Burdensome Manner – Gov. Code Section 11346.3(e):

The proposed regulations have been determined to be the most efficient and effective means of implementing the law in the least burdensome manner.

Determination of Inconsistent/Incompatible Existing Regulations – Gov. Code Section 11346.5(a)(3)(D):

An evaluation of the proposed regulations has determined they are not inconsistent/incompatible with existing regulations, pursuant to Government Code section 11346.5(a)(3)(D).

Reasonable Alternatives that Would Lessen the Impact on Small Businesses – Gov. Code Section 11346.2(b)(4)(B):

There are no reasonable alternatives that would lessen the impact to small businesses because this regulation would have no fiscal impact on small businesses.