

ATTORNEY GENERAL'S LEGISLATIVE PROGRAM
PROGRAM BILL #06-03

Assembly #

Senate #

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MEMORANDUM

AN ACT to amend the education law, in relation to
oversight of accountants

PURPOSE:

This bill improves oversight of the accounting industry in New York State, including through the adoption reforms similar to those enacted by the federal Sarbanes-Oxley law last year.

SUMMARY OF PROVISIONS:

Section 1 of the bill amends Education Law § 6508 to permit the appointment of additional public representatives to the State Board for Public Accountancy.

Section 2 of the bill amends Education Law § 7401 to update the definition of the practice of public accountancy, and to make clear that in-house accountants must be licensed.

Section 3 of the bill adds a new Education Law § 7401-a, which includes definitions of the terms "attest," "certified public accountant," "compilation," "firm," and "public accountant."

Section 4 of the bill amends Education Law § 7402 to provide that only a certified public accountant or a public accountant may engage in the practice of public accountancy.

Section 5 of the bill amends Education Law § 7403: (a) to alter the composition of the State Board for Public Accountancy, by requiring at least 16 licensed accountants and 9 public representatives (rather than the current composition of at least 20 licensed accountants and at least 2 public representatives); (b) to permit the Board of Regents to appoint a non-accountant as executive secretary to the State Board of Public Accountancy; and (c) to clarify that the qualifications for public representatives. Section 7403 is also amended to provide that, where SED is investigation a complaint alleging professional misconduct against a public accountant, the professional conduct officer must obtain the written concurrence of a public representative before either determining that no further action should be taken, or deciding to terminate the investigation through the issuance of an administrative warning.

Section 6 of the bill amends Education Law § 7408 to clarify that the provisions authorizing accountants to form partnerships also authorizes the formation of professional corporations, limited liability companies and other similar organizations, and that the restrictions on such practices apply to the partners, owners and shareholders of such entities. This section also makes clear that all such public accountancy firms must be registered with SED pursuant to regulations adopted by SED.

Section 7 of the bill adds seven new sections (§ 7410 through § 7416) to the Education Law.

New Education Law § 7410 sets forth specific acts – such as embezzlement, fraud, knowing preparation of false financial statements, and conduct resulting in the suspension of the right to practice accountancy before a government agency – that shall constitute professional misconduct.

New Education Law § 7411 prohibits accountants from: (a) receiving commissions for performing public accountancy services; (b) obtaining fees for referring clients to third parties; and (c) obtaining fees for the sale of products to clients unless specific disclosure requirements are met.

New Education Law § 7412 requires accountants to report certain actions – such as convictions or license suspensions in other states, civil judgments relating to accountancy, the commencement of investigations by federal authorities – that may affect their ability to practice accountancy.

New Education Law § 7413 mandates the retention of audit documentation, and sets forth the consequences for failure to retain such documentation.

New Education Law § 7414: (a) prohibits accounting firms from providing attestation services for companies whose executives were employed by the accounting firm within the previous 12 months; (b) prohibits accountants from accepting employment with clients if they both performed attestation services for the client within the prior 12 months, and would have oversight over the client's financial reporting; (c) requires the rotation of lead audit partners every 5 years; (d) prohibits accountants from providing attestation services for clients in which they have a financial interest; (e) prohibits accountants from providing a wide variety of "consulting services" for their clients, except that SED can provide exemptions on a case-by-case basis; and (f) prohibits accountants from providing certain accountancy services for corporate executives if they perform similar services for the corporation. This section authorizes SED to issue regulations exempting services provided to small business clients in certain circumstances.

New Education Law § 7415 requires "peer review" of the attest and compilation services of accounting firms every three years. Such peer reviews must be conducted by reviewers approved by SED, and the results of the reviews must be filed with SED.

New Education Law § 7416 imposes fines for professional misconduct of up to \$20,000 for an individual licensee and \$200,000 for a firm. If the misconduct involves fraud (or deliberate or reckless disregard for the law), the penalties can be up to \$50,000 for an individual and \$500,000 for a firm.

The bill becomes effective 180 days following enactment.

EXISTING LAW:

Education Law § 7403 currently provides that the State Board for Public Accountancy must have at least 20 licensed accountants and 2 public representatives. There are no statutory provisions relating to the independency of the public representatives.

Education Law § 6509 sets forth certain activities that constitute professional misconduct by a member of any profession, but there are no statutory provisions setting forth specific actions that constitute professional misconduct by accountants. Similarly, there are no state statutes: (a) prohibiting accountants from working on a commission basis, or from obtaining fees for referring clients to third parties; (b) requiring accountants to report certain adverse actions that may affect their ability to practice accountancy; (c) mandating the retention of audit documentation; or (d) setting forth conflict of interest provisions.

JUSTIFICATION:

The recent scandals at Enron, Arthur Anderson, Global Crossing, Tyco and other major corporations clearly demonstrate the need for significant legislative reforms to protect New York residents from similar corporate abuses in the future. This bill – which is one of six bills being proposed by the Attorney General as part of the Corporate Fraud Prevention Initiative of 2003 – seeks to improve oversight of the accounting industry in New York State.

The federal Sarbanes-Oxley law passed by Congress last year (Public Law 107-240) enacted important reforms relating the auditing of publicly-listed companies. For example the Sarbanes-Oxley bill:

- creates a new Public Company Accounting Oversight Board;
- requires that auditors be hired by, and report to, the company's audit committee;
- prohibits accounting firms from auditing companies if the CEO or other high corporate official previously worked for the auditor and participated in the company audit the previous year;
- prohibits auditors from providing consulting and other services to the companies that they audit;

- requires that accounting firms rotate the lead partner auditing client companies every five years.

The Sarbanes-Oxley law only applies to firms that audit publicly-listed companies (e.g., companies listed on the New York Stock Exchange, American Stock Exchange or NASDAQ), and thus thousands of accountants and accounting firms in New York are not covered by these new federal requirements. Other states are moving quickly to upgrade their accounting oversight statutes. For example, last year California enacted legislation: (1) requiring that a majority of its Board of Accountancy be public representatives; (2) prohibiting accountants from receiving commissions or referral fees except in limited circumstances; (3) requiring that accountants report certain events that may impact their ability to practice accountancy; and (4) setting forth strict conflict of interest provisions.

New York State's accountancy laws are out-of-date, and it is essential that we upgrade these laws to ensure that New Yorkers are protected from future financial frauds. This bill accomplishes this goal by amending the Education Law to incorporate many of the protections set forth in the Sarbanes-Oxley law and in the new California law. In particular, this bill:

- updates the definition of the practice of public accountancy;
- alters the composition of the State Board for Public Accountancy, by requiring at least 16 licensed accountants and 9 public representatives (rather than the current composition of 20 licensed accountants and 2 public representatives), and ensures that the public representatives of the State Board are independent of the accountancy profession;
- ensures that investigations into professional misconduct cannot be terminated without the written concurrence of a public representative of the board;
- sets forth specific fraudulent and improper acts that shall constitute professional misconduct;
- prohibits the receipt of commissions or referral fees except in certain circumstances;
- requires accountants to report actions that may affect their ability to practice accountancy;
- mandates the retention of audit documentation;
- prohibits accounting firms from providing attestation services for companies whose executives were employed by the accounting firm within the previous 12 months;

- prohibits accountants from accepting employment with clients if they both audited the client within the past year and would have oversight over the client's financial reporting;
- requires the rotation of lead audit partners every 5 years;
- prohibits accountants from providing attestation services for clients in which they have a financial interest;
- prohibits accountants from providing specified "consulting services" for their clients;
- prohibits accountants from providing certain accountancy services for corporate executives if they perform similar services for the corporation;
- requires that all accounting firms undergo peer review every three years; and
- increases the fines for professional misconduct.

Together, these changes will greatly enhance the oversight of the accounting profession in New York State, and thereby protect the State's residents against financial frauds in the future.

LEGISLATIVE HISTORY:

This is a new bill.

FISCAL IMPLICATIONS:

None.

EFFECTIVE DATE:

The bill takes effect 180 days after enactment.