

**Testimony
of
The New York State Society of Certified Public Accountants
before the
New York State Senate Higher Education Committee
Kenneth P. LaValle, Chairman**

**Public Hearing: Reform and Oversight Legislation for CPAs
January 25, 2005**

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**Van Buren Hearing Room A
Legislative Office Building
Second Floor, Albany, New York**

Senator LaValle and distinguished members of the committee, thank you for the opportunity to appear before you this morning on the important subject of reform of the accountancy profession in New York State. I am the Executive Director of the New York State Society of Certified Public Accountants, the oldest and largest CPA Society in the United States, with over 30,000 members. I am joined this morning by Kevin J. McCoy CPA, Chairman of our Legislative Task Force, who is also the Managing Director of Marvin and Company P.C, a CPA firm based in the Capital District.

Senator LaValle, with your leadership, the State Senate has twice unanimously passed accounting reform legislation in 2003 and 2004, only to see an identical bill sit in committee in the Assembly. The time for passage of your legislation is long overdue. Your press release for today's hearing correctly states that you held public hearings on accountancy reform in 2000, and now, as it did then, the Society is calling on both houses of the legislature to pass your accountancy reform legislation.

S302-D complements the legislation Comptroller Alan Hevesi has proposed for school district accountability. We strongly support the Comptroller's proposals for legislation, which you are co-sponsoring with Senator Saland, Senator Balboni, and Assemblyman DiNapoli. In fact, we joined with the Comptroller and educational organizations to develop a comprehensive approach for school district accountability. Just as laws governing accountability in school districts must be reformed by passage of the Comptroller's proposals for legislation, the accounting profession and the public need the accounting reforms passed by the Senate during the last two sessions.

Under the guidance of the Comptroller and the State Education Department, the school boards, with the assistance of independent CPA firms, are the gatekeepers for the

taxpayers of every school district. The public has the expectation that an audit by a CPA firm will add assurance that taxpayer dollars are used for the intended purpose of educating our children. Comptroller Hevesi's proposal enhances financial accountability of the school districts through:

- ✚ mandatory fiduciary and financial training for school board members;
- ✚ establishment of the position of claims auditor who reports directly to the school board;
- ✚ establishment of an internal audit function in each district;
- ✚ establishment of a school board audit committee;
- ✚ a Request for Proposal process for the hiring of a district's independent auditor for an engagement term of no longer than 5 years at a time; and
- ✚ public reporting of the annual audit opinion by the CPA to the school board.

The State Society strongly supports the objectives and substance of this proposed legislation, but recognizes that more needs to be done to restore the public's confidence in all audits performed by CPAs - not just audits of school districts. In addition, we continue to strongly support the objectives and substance of Senate 302-D. The proposed legislation regarding school districts will ensure that citizens can have increased confidence that their tax dollars are directly connected to the education of children. Similarly, the Society believes that Senate 302-D will give all the citizens of New York a higher level of confidence in all audited financial transactions whether they deal with 401(k)s or stocks, or pensions. Your bill, Senator LaValle will do that.

On a federal level, Congress responded promptly to the financial problems at Enron, WorldCom and other major publicly traded companies that caused financial harm to

investors throughout New York State and the country. Congress instituted sweeping reforms by passage of the Sarbanes-Oxley Act of 2002, and with the creation of a new oversight and enforcement body, the Public Company Accounting Oversight Board. However, governance of the practice of accounting and the licensing of CPAs continues to be a responsibility of the states.

The New York State Legislature passed the first licensing law in the country in 1896. That law has not been substantially amended since 1947. Regulation of the CPA profession has been stuck in time as the global economy, technology and new business practices have dramatically altered the practice of accounting since 1947. After more than 50 years, it is time for the legislature to pass the reforms you have championed.

As a membership organization that includes the vast majority of CPAs in New York, we are calling for the legislature to update the statutory and regulatory environment for the twenty-first century.

First, I want to address a fundamental problem in New York's accountancy law that your bill will correct. Currently, a CPA's performance when working as a financial officer in a school district or BOCES or as a chief financial officer in a publicly traded or closely held corporation in New York is not regulated by the state's accountancy law. Generally, their licenses are subject to revocation in New York State only upon conviction of a crime. This occurs because only CPAs engaged in the practice of public accountancy, defined as working in a public accounting firm, are regulated and therefore only they can be disciplined for professional misconduct.

Your bill would change that and require every CPA, including CPAs employed in private industry or government, be regulated and required to comply with all New York's accountancy laws and rules. Your bill would require all CPAs, including those in private industry or government, to meet continuing education requirements and to register triennially with the State Education Department. Those CPAs are currently exempt from both registration and CPE requirements. The flawed accounting schemes in certain major companies and embezzlement activities in certain school districts on Long Island no longer justify these exemptions in our state laws.

Another failure of our antiquated accountancy laws is that only CPA firms registered as partnerships are now required to register triennially with the State Education Department. Your bill would change this and require all firms regardless of the form of legal entity, including sole proprietorships, LLCs and PCs, to register with the department triennially and be subject to regulation, fines, and other discipline. Further, your bill will substantially raise the fines for violation of New York's accountancy laws and rules to \$20,000 per incident for a firm and up to \$250,000 per incident for fraud or reckless disregard of accounting laws and rules. Fraud charges against an individual CPA would result in a fine of up to \$50,000. This is substantially above the current \$10,000 per incident for the other 43 professions licensed under the Education Law. In conjunction with this change, your bill would provide sufficient due process protections for CPAs that would face these higher fines, which we believe is essential.

Your bill will address two other problems in current New York laws. New York and Wisconsin are the only two states in the country that do not meet the national standard of a three-year minimum of 120 hours of continuing professional education for CPAs. This is surprising, particularly in light of the fact that New York is the financial capital of

the world. Your bill will cure this. We do not agree with the State Education Department's opposition to your provision to raise the continuing education requirements for New York CPAs to what has become the national standard.

Additionally, 37 states now require mandatory peer review as a condition of renewing a CPA firm's registration; New York does not. Your bill would require peer review (where one firm attests to the quality control system and work product of another) of all CPA firms that perform the attest or compilation services. This program is now part of the Society's self-regulatory administration of peer review, but under your bill, the process would see monumental change. The State Education Department would set the standards, impose minimum qualifications for peer reviewers and link the results of a peer review to the State's disciplinary process. With your bill, a governmental body will in essence oversee the peer review program. The State Education Department, under your bill, could if they so elected, establish specific peer review requirements for CPA firms that audit school districts. If your bill had been law, audit failures such as those identified in the Comptroller's report may have been identified. We want peer reviews to be thorough, and we support your provision that will make peer review results public under the State's Freedom of Information Law.

Next, we want to address independence issues. Independence is the cornerstone of the CPA profession. Both your bill and Comptroller Hevesi's proposal use the term independence or independence standards. It is a fundamental principle of the profession that a CPA does not audit his or her own work, does not have a direct or indirect financial interest in the audit client, and does not make management decisions for the audit client. I am not sure you want to add these principles to legislation, but if

you do, I suggest that you do so word for word and do not paraphrase. This will avoid unnecessary confusion between federal language and state language.

Your bill specifically defines the attest service as a service that requires the meeting of independence standards. Similarly, the Government Accountability Office has standards (called the Yellow Book) that apply to audits of entities that receive federal funds. The strong and well-defined independence standards in the Yellow Book are the law of the land for all audits of governmental units that spend over \$500,000 of federal dollars. This would include all school districts, to my knowledge. The Yellow Book independence standards address comprehensively personal, external, and organizational impairments of auditor independence. They also deal extensively with auditors' provision of nonaudit services, permitting only those that do not involve performing management functions or management decisions and those that are unrelated to the subject matter of the audit. If those two overarching principles are met, then seven additional safeguards must also be met. The Yellow Book standards do not permit auditors to perform bookkeeping services nor do they permit auditors to install or maintain accounting software systems for attest clients.

We maintain that a review of compliance with the Yellow Book's standards for independence should be an integral part of a peer review of any firm that audits a school district or any other entity receiving federal funds. Under your bill, any firm whose peer review finds a violation of these independence standards could lose its registration and be subject to substantial fines. If your bill becomes law, the State Society is committed to the successful operation of the state's mandatory peer review program, which would be funded by fees charged to the firms being peer reviewed.

While it is not directly on point to the discussion of school district audits, I want you to know that the State Society endorses the expansion of the scope of regulated practice in your bill to cover services rendered by CPAs, whether in public practice, private industry, or government. Nonetheless, the attest and compilation services are professional services that must be exclusive to the CPA profession, and we must do everything necessary to maintain that exclusive public trust to provide those services.

Another point I wish to address is that your bill clarifies that no CPA who provides an audit service to a client shall receive a commission or referral fee from a third party for referral of a service or product. This restriction would apply during the period covered by the audit and during the period in which the engagement is performed. Had your bill become law in 2000, as a matter of state law it would have prohibited the referral of an audit client by a CPA firm to a software company partly owned by one of the partners in the CPA firm. Under your bill, this would be an indirect commission or referral fee to a partner in the CPA firm, and the firm would risk imposition of fines or other discipline, or loss of its registration.

Had your bill been law, the misuse of the software documented in the Comptroller's report may not have occurred. Under your bill, the CPA firm would have been obligated to withdraw from the audit engagement before receiving a commission or referral fee based upon the sale of the software to its audit client school district. The importance of such checks and balances is crystallized when you consider that the one firm alleged to have conducted inadequate audits of a Long Island school district, alone audited over \$3.2 billion in school districts and BOCES expenditures.

Your provision on commissions and referral fees provides clarity for CPAs and CPA firms that such arrangements would not be allowed for an audit client. Your provision is much clearer and protective of the public. It also underscores the importance of maintaining the CPA's independence with respect to the audit client.

The Society will continue its strong support for passage of both your accounting reform bill, Senator LaValle, and Comptroller Hevesi's proposal to enhance school district accountability.

The Society is calling for more funding for the Comptroller to audit school districts throughout the state.

It is our understanding that the Governor's Article VII bill contains language similar to, but not identical to, that of the school district auditing reform bill that you are sponsoring. It is also our understanding that the major difference between the governor's proposal and the language contained in the school district auditing bill, relates to forced rotation of auditing firms. We believe that forced rotation would create service delivery problems in many, many areas of the state and we support your approach, which involves a mandatory requests for proposal process.

Mr. McCoy and I will respond to any question you may have, including any questions on school district auditing where Mr. McCoy has experience.

Thank you.

