

CALIFORNIA BOARD OF ACCOUNTANCY

INITIAL STATEMENT OF REASONS

Hearing Date: November 19, 2015

Subject Matter of Proposed Regulations: Peer Review - Exclusion

Section(s) Affected: Title 16, Division 1, section 42

Specific Purpose of each adoption, amendment, or repeal:

1. Amend Section 42

Problem being addressed:

A “peer review” is a study, appraisal, or review conducted in accordance with professional standards of the professional work of a firm. California Business and Professions Code (BPC) section 5076(a) requires all accounting firms to have a peer review report of its accounting and auditing practice every three years. Title 16, California Code of Regulations (CCR) section 39 defines an accounting and auditing practice to include any services that are performed using the following professional standards:

- Statements on Auditing Standards (SASs)
- Statements on Standards for Accounting and Review Services (SSARS)
- Statements on Standards on Attestation Engagements (SSAEs)
- Government Auditing Standards
- Audits of non-Security Exchange Commission (SEC) issuers performed pursuant to the standards of the Public Company Accounting Oversight Board (PCAOB).

In November 2014, the American Institute of CPA's (AICPA) Peer Review Board (PRB) issued an exposure draft of revised Standards for Performing and Reporting on Peer Reviews that would exclude firms that only perform preparation engagements (with or without disclaimer reports) under Statement on Standards for Accounting and Review Services (SSARS) from enrollment in the peer review program. However, for firms that are otherwise required to undergo peer review, engagements to prepare financial statements would fall within the scope of the peer review. At its January 2015 meeting, the PRB adopted the proposed changes.

In reviewing the proposed revisions to the SSARS standard at its August 22, 2014 meeting, the CBA's Peer Review Oversight Committee (PROC) reasoned that since the preparation of financial statements is a lower level service than compilations where no report is issued in accordance with the provisions of SSARS, the new preparation engagement service should be similarly exempted from peer review.

In October 2014, the AICPA issued SSARS No. 21, which supersedes all but one of the prior standards. The SSARS 21 changes clarify and revise the standards for reviews, compilations, and engagements to prepare financial statements. CPA's that as the highest level of service provided only compilations where no report is issued were previously excluded from peer review. As a result of the clarification and revision of the standard, compilations where no report is issued no longer exists and is now replaced by preparation engagements (with or without disclaimer reports).

The changes to SSARS create a distinct separation between accounting (preparation) and reporting (compilation) services. When only preparing financial statements, the accountant would no longer have to be concerned whether the financial statements are to be used internally by knowledgeable parties or by third parties. The AICPA viewed this reporting obligation as a management function. Consequently, a report would not be required even when the financial statements are expected to be used by or presented to a third party. This new preparation engagement standard will apply when an accountant is engaged to prepare financial statements but is not engaged to perform an audit, review, or compilation on those financial statements.

Existing law at CCR section 42 excludes from peer review firms, which at their highest level of work, perform only compilations where no report is issued. However, as currently written, CCR section 42 does not exempt preparation engagements from peer review, even though no report will be issued by the accountant performing this service.

The CBA has received inquiries related to SSARS 21 and its impact on the peer review requirement for California accounting firms. To provide added clarity to the regulatory text for the regulated public and remain consistent with the latest changes to SSARS, amendment of the language specifically excluding firms, which as their highest level of work, perform only preparation engagements (with or without disclaimer reports) is proposed. Changes in the standard developed by the AICPA that amended the definition of service clarifies the scope of service provided to the public.

Anticipated benefits from this regulatory action:

This regulatory amendment would clarify language in CCR, Title 16, section 42 regarding the firms that are excluded from the peer review requirement. Amending the language will benefit firms by providing clarity regarding whether they are subject to the peer review requirement in California if the firms only perform preparation engagements as their highest level of work.

Factual Basis/Rationale

Factual basis for determination that each proposed change is reasonably necessary to address the problem for which it is proposed:

BPC section 5076(c) authorizes the CBA to adopt regulations regarding exclusions from the peer review requirement.

This regulatory proposal would amend language in CCR section 42 to exclude firms, which as their highest level of work, perform only preparation engagements (with or without disclaimer reports) in accordance with the provisions of SSARS.

The issuing of SSARS 21 by the AICPA creates a new level of accounting and auditing service for engagements to prepare financial statements. The CBA's regulations presently do not directly address this type of service. The replacement of compilation without report to preparation engagements (with or without disclaimer reports) is the result of changes in the standard developed by the AICPA. This amended language clarifies the service provided to the public.

Underlying Data

Technical, theoretical or empirical studies, reports, or documents relied upon (if any):

- American Institute of Certified Public Accountants (AICPA), Statement on Standards for Accounting and Review Services (SSARS) No. 21.
- Minutes of the August 22, 2014 PROC meeting
- Memo from Rafael Ixta, Chief of Enforcement and Seid Sadat, PROC Member dated July 22, 2014 with attachments
- Minutes of the May 28-29, 2015 CBA Meeting

Business Impact

This regulation will not have a significant adverse economic impact on businesses. This initial determination is based on the following facts or evidence/documents/testimony:

Existing law excludes firms, which as their highest level of work, perform only compilations where no report is issued. The proposed amendment would clarify and specifically exclude those firms, which as their highest level of work, perform only preparation engagements (with or without disclaimer reports) from the peer review requirement.

Economic Impact Assessment

This regulatory proposal will have the following effects:

- It will not create or eliminate jobs within the State of California because it only clarifies that firms, which as their highest level of work, perform only preparation engagements (with or without disclaimer reports) are excluded from the peer review requirement and is not of sufficient magnitude to affect the expansion of jobs within the State of California.
- It will not create new businesses or eliminate existing businesses within the

State of California because it only clarifies which firms would be excluded from peer review that have an accounting and auditing practice and is not of sufficient magnitude to create or eliminate businesses in the State of California.

- It will not affect the expansion of businesses currently doing business within the State of California because it only clarifies which firms would be excluded from peer review that have an accounting and auditing practice and is not of sufficient magnitude to affect the expansion of business within the State of California.
- This regulatory proposal does not affect the health and welfare of California residents because it has nothing to do with health and welfare.
- The regulatory proposal does not affect worker safety because it has nothing to do with worker safety. The regulatory proposal only impacts those accountancy firms that would be excluded from peer review and does not affect worker safety.
- This regulatory proposal does not affect the state's environment because it has nothing to do with the California environment.

Specific Technologies or Equipment

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

Consideration of Alternatives

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.

Set forth below are the alternatives which were considered and the reasons each alternative was rejected:

Alternative: The CBA considered not amending Section 42 to clarify which firms would be excluded from peer review.

Rejected: The alternative was rejected because the regulatory proposal clarifies that the level of services has been redefined and compilation with or without report has been replaced by preparation engagements (with or without disclaimer reports). Peer review is not necessary for this level of service.