

REGULATORY AGENCY ACTION



STATE & CONSUMER SERVICES AGENCY

(Department of Consumer Affairs)

BOARD OF ACCOUNTANCY

Executive Officer: Carol Sigmann
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The Board of Accountancy (BOA) licenses, regulates, and disciplines certified public accountants (CPAs). The Board also regulates and disciplines existing members of an additional classification of licensees, public accountants (PAs); the PA license was granted only during a short period after World War II. BOA currently regulates over 50,000 licensees. The Board establishes and maintains standards of qualification and conduct within the accounting profession, primarily through its power to license. The Board's enabling act is found at section 5000 et seq. of the Business and Professions Code; the Board's regulations appear in Title 16, Division 1 of the California Code of Regulations (CCR).

The Board consists of twelve members: eight BOA licensees (six CPAs and two PAs), and four public members. Each Board member serves a four-year term and receives no compensation other than expenses incurred for Board activities.

The Board's staff administers and processes the nationally standardized CPA examination, a four-part exam encompassing the categories of Audit, Law, Theory, and combined sections Practice I and II. Applicants must successfully complete all four parts of the exam and 500 hours of qualifying auditing work experience in order to be licensed. Approximately 20,000 examination applications are processed each year. Under certain circumstances, an applicant may repeat only the failed sections of the exam rather than the entire exam. BOA receives approximately 4,000 applications for licensure per year.

The current Board officers are President Ira Landis, Vice President Janice Wilson, and Secretary/Treasurer Jeffery Martin. At the Board's January 31 meeting, new public member Karen Mier was introduced to the Board.

MAJOR PROJECTS:

Governor Proposes Increased BOA Budget. The 1991-92 Governor's Budget proposes significant changes for BOA, including an increase of \$1,271,000 and 20 personnel years; the changes were proposed to address the Board's increasing workload and corresponding support services attributable to the increase in staff. Included in the proposal are \$668,000 and eight personnel years to establish a permanent enforcement staff of CPAs, as opposed to using volunteer CPAs to perform enforcement work. If the legislature approves the Governor's proposal, BOA's 1991-92 budget will be \$7,145,000.

Board Continues to Seek Disciplinary Action Against Former Lincoln Savings and Loan Auditors. BOA is continuing its efforts to revoke or suspend the California license of Ernst & Young, one of the nation's largest accounting firms, for alleged gross negligence in audits of Irvine-based Lincoln Savings & Loan and its parent company, American Continental Corporation (ACC). (See CRLR Vol. 11, No. 1 (Winter 1991) p. 48 for background information.) Ernst & Young is the result of the 1989 merger of the former Ernst & Whinney and Arthur Young & Co. The Board charges that the firm's gross negligence resulted in reliance by small investors on faulty financial statements in purchasing approximately \$200 million in now-worthless ACC junk bonds at Lincoln branches. Federal regulators also relied on the firm's report and consequently delayed the seizure of Lincoln, a delay that will cost taxpayers an estimated \$2.5 billion. Ernst & Young has tentatively agreed to pay the federal government more than \$40 million in penalties in connection with its work, in order to avoid litigation.

LEGISLATION:

SB 869 (Boatwright). Existing law establishes educational prerequisites for admission to the examination for a CPA certificate, requiring applicants to have 45 semester hours of instruction in four-year or two-year institutions in specified subjects or the equivalent, or be a public

accountant. As introduced March 7, this bill would amend those requirements by revising provisions relating to accreditation of the educational institutions, and by providing for qualification by examination by BOA rather than by an agency approved by the Department of Education. This bill would also, as of January 1, 1997, require that applicants have 150 semester hours of education in a four-year institution or the equivalent, or be a public accountant, in order to be eligible for CPA licensure. (See CRLR Vol. 11, No. 1 (Winter 1991) p. 47 for background information.) This bill is pending in the Senate Business and Professions Committee.

AB 965 (Alpert), as introduced March 4, would extend the sunset date on section 5173 of the Business and Professions Code, which authorizes BOA to contract with a nonprofit organization controlled by Board licensees to provide volunteer accounting services within the state, to January 1, 1997. This bill is pending in the Assembly Committee on Consumer Protection, Governmental Efficiency, and Economic Development.

AB 1142 (Chacon), as introduced March 5, is a spot bill which would make technical changes in section 5036 of the Business and Professions Code, which specifies that the term "certified public accountant" includes "public accountant" for specified purposes. This bill is pending in the Assembly Consumer Protection Committee.

LITIGATION:

In *Union Bank v. Ernst & Whinney*, 227 Cal. App. 3d 1389 (Feb. 26, 1991), the Second District Court of Appeal held that Ernst & Young is not liable to Union Bank for a \$7 million loan default resulting from the ZZZZ Best (Z Best) stock swindle. The accounting firm was hired in 1986 to review interim financial statements prepared by Z Best in connection with a \$100 million stock offering. Z Best's preliminary prospectus regarding the stock offering included a draft of the firm's unsigned review report. Union Bank, which subsequently extended a \$7 million line of credit to Z Best, maintained that it relied on that review and certain oral representations in approving the loan. The bank's amended complaint against Ernst & Young included causes of action for fraud, conspiracy to defraud, negligent misrepresentation, and professional negligence, claiming detrimental reliance on the firm's oral representations of Z Best's financial condition.

In a 2-1 decision, the appellate court affirmed the trial court's holding that the claims against the accounting firm were



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barred by the statute of frauds, which requires that representations regarding the creditworthiness of a third party be in writing and signed by the attester. The court acknowledged two narrow exceptions to this rule: the doctrine of estoppel (where a fiduciary relationship exists between the bank and the accounting firm), and where the defendant derives some benefit from the transaction. The court stated that "[n]either circumstance is extant in this case," and ruled that Ernst & Young was not attesting to the financial soundness of Z Best.

In dissent, Justice Earl Johnson argued that the validity of the review and the bank's reliance on the firm's assertions are questions of fact and should be adjudicated. According to Justice Johnson, "[t]he implications of this case go far beyond one bank and one accounting firm.... This state and this nation have entered an era where many innocent citizens, taxpayers, bondholders, and shareholders alike, are being asked to bear the financial burden for fraudulent business arrangements—and often the resultant failure of banks and similar institutions—they had nothing whatsoever to do with. How can we ask them to do so if the courts let off the hook those, including accountants, who are not totally innocent—indeed whose own actions may have contributed to the perpetration of the fraud and to the ensuing losses.... As between innocent taxpayers and negligent (or worse) accounting firms, who should bear the cost...?" He further noted that the majority decision regarding the absence of duty, "if followed by other California courts, could insulate all accountants from responsibility for representations made about and in their written review reports."

RECENT MEETINGS:

At the Board's January 31 meeting, the Administrative Committee reported that 300 of BOA's pending disciplinary cases were received by the Board prior to 1988. Approximately half of these cases remain within the purview of the Administrative Committee; the rest reside in the Attorney General's Office, the Department of Consumer Affairs' Division of Investigation, or the Office of Administrative Hearings.

Also in January, BOA's Continuing Education Committee recommended that nonpracticing licensees be required to complete at least 60 hours of continuing education (CE) for each two-year renewal period (30 hours per year). A trade association representative stated that nonpracticing licensees should be subject to the same 80-hour biennial CE requirement as those who are actively

performing public accounting services. The Board decided to research this issue further and revisit it at its September meeting.

At the Board's January meeting, Ira Landis was elected BOA President, taking over for Jack Kazanjian. Janice Wilson was elected Vice President, filling the position left open by Mr. Landis' advancement to President. Jeffery Martin was reappointed as Secretary-Treasurer.

FUTURE MEETINGS:

To be announced.

BOARD OF ARCHITECTURAL EXAMINERS

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The Board of Architectural Examiners (BAE) was established by the legislature in 1901. BAE establishes minimum professional qualifications and performance standards for admission to and practice of the profession of architecture through its administration of the Architects Practice Act, Business and Professions Code section 5500 *et seq.* The Board's regulations are found in Division 2, Title 16 of the California Code of Regulations (CCR). Duties of the Board include administration of the Architect Registration Examination (ARE) of the National Council of Architectural Registration Boards (NCARB), and enforcement of the Board's statutes and regulations. To become licensed as an architect, a candidate must successfully complete a written and oral examination, and provide evidence of at least eight years of relevant education and experience. BAE is a ten-member body evenly divided between architects and public members. Three public members and the five architects are appointed by the Governor. The Senate Rules Committee and the Speaker of the Assembly each appoint a public member.

MAJOR PROJECTS:

Regulatory Changes. BAE is in the process of amending section 134, Title 16 of the CCR, to ensure that all types of architectural businesses are required to advertise similarly. Currently, section 134 allows architectural partnerships whose business names consist of the surnames of its general partners who are licensed architects to forego having to identify in their title the name of a licensed architect and the fact that he/she is a licensed architect. The proposed change under discussion since September 1990 would require all architectural

partnerships to list in their title or designation the name of a general partner and the fact that he/she is a licensed architect. (See CRLR Vol. 11, No. 1 (Winter 1991) p. 48 and Vol. 10, No. 4 (Fall 1990) p. 52 for background information.) At its January 18 meeting, the Board decided not to adopt the proposed amendment as written. BAE hopes to rewrite the proposal, publish the modified version by the end of March, and schedule a public hearing in May.

BAE Adopts Regulation Implementing New Architect Stamp Requirement. Effective January 1, 1991, AB 1005 (Frazee) (Chapter 94, Statutes of 1990) requires architects to affix a stamp to all plans, specifications, and instruments of service when submitting them to a governmental entity for approval or issuance of a permit. Because AB 1005 did not provide specific language describing the size, shape, and type of stamp, the Board adopted proposed regulatory language resolving this issue at its January 18 meeting. (See CRLR Vol. 11, No. 1 (Winter 1991) p. 48 and Vol. 10, Nos. 2 & 3 (Spring/Summer 1990) p. 68 for background information.) New section 136, Title 16 of the CCR, would require that the stamp be not less than one inch in diameter in order to ensure that the stamp will be easy to see and read, and not more than two inches in diameter since it is standard practice in the design industry to use this size. The required dimensions are consistent with the dimensions of stamps used by architects and engineers throughout the country. The new regulatory section awaits review and approval by the Office of Administrative Law.

Americans With Disabilities Act Accessibility Regulations Published. The federal Americans with Disabilities Act of 1990 (ADA), 42 U.S.C. § 12101 *et seq.*, established comprehensive civil rights protections for disabled people, by generally requiring that newly built or altered restaurants, hotels, theaters, businesses, retail stores, shopping centers, and malls, as well as state and local government offices, transit facilities, and vehicles, must be usable by persons with disabilities.

The U.S. Department of Justice delegated authority to draft and enforce the implementing regulations to the U.S. Architectural and Transportation Barriers Compliance Board (ATBCB). ATBCB's proposed regulations appeared in the *Federal Register* on February 22; hearings on these regulations were scheduled to take place in San Francisco on March 18 and 19. Under the Act, the ATBCB is required to publish its final guidelines by April 26.