

**SUNSET EVALUATION REPORT**  
**PUBLIC ACCOUNTANCY**  
**Chapter 466, Hawaii Revised Statutes**

**A Report to the Governor and the Legislature of the State of Hawaii**

**Submitted by the**  
**Legislative Auditor of the State of Hawaii**

**Report No. 83-6**  
**January 1983**

## FOREWORD

Under the "sunset law," licensing boards and commissions and regulated programs are terminated at specified times unless they are reestablished by the Legislature. Nationally, the first sunset law was passed in 1976. Within three years, 30 more states had enacted similar legislation. The rapid spread of sunset legislation reflects increasing public concern with what it sees as unwarranted government interference in everyday activities.

Hawaii's Sunset Law, or the Hawaii Regulatory Licensing Reform Act of 1977, scheduled for termination 38 occupational licensing programs over a six-year period. These programs are repealed unless they are specifically reestablished by the Legislature. In 1979, the Legislature assigned the Office of the Legislative Auditor responsibility for evaluating each program prior to its repeal.

This report evaluates the regulation of accountants under Chapter 466, Hawaii Revised Statutes. It presents our findings as to whether the program complies with the Sunset Law and whether there is a reasonable need to regulate accountants to protect public health, safety, or welfare. It includes our recommendation on whether the program should be continued, modified, or repealed.

Our approach to the evaluation of the regulation of accountants is described in Chapter 1 of this report under "Framework for Evaluation." That framework is also used for all our other sunset evaluation reports. It is based on the policies enunciated by the Legislature in the Sunset Law. The first and basic test we applied was whether an identifiable danger to public health, safety, or welfare could result from the conduct of the occupation or profession being regulated. Then the other criteria for the evaluation were applied.

We acknowledge the cooperation and assistance extended to our staff by the Board of Public Accountancy, the Department of Commerce and Consumer Affairs, and other officials contacted during the course of our examination.

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## Chapter 1

### INTRODUCTION

The Hawaii Regulatory Licensing Reform Act of 1977, or Sunset Law, repeals statutes concerning 38 state licensing boards and commissions over a six-year period. Each year, six to eight licensing statutes are scheduled to be repealed unless specifically reenacted by the Legislature.

In 1979, the Legislature amended the law to make the Legislative Auditor responsible for evaluating each licensing program prior to its repeal and to recommend to the Legislature whether the statute should be reenacted, modified, or permitted to expire as scheduled. In 1980, the Legislature further amended the law to require the Legislative Auditor to evaluate the effectiveness and efficiency of the licensing program, even if he determines that the program should not be reenacted.

#### **Objective of the Evaluation**

The objective of the evaluation is: To determine whether, in light of the policies set forth in the Sunset Law, the public interest is best served by reenactment, modification, or repeal of Chapter 466, Hawaii Revised Statutes.

#### **Scope of the Evaluation**

This report examines the history of the statute on licensing of public accountants and the public health, safety, or welfare that the statute was designed to protect. It then assesses the effectiveness of the statute in preventing public injury and the continuing need for the statute.

#### **Organization of the Report**

This report consists of three chapters: Chapter 1, this introduction and the framework developed for evaluating the licensing program; Chapter 2, background information on the regulated industry and the enabling legislation; and Chapter 3, our evaluation and recommendation.

*NOTE: Originals for pages 2-5 are filed with Report No. 83-7,  
Sunset Evaluation Report, Real Estate Brokers and Salesmen,  
Chapter 467, Hawaii Revised Statutes.*

## Chapter 2

### BACKGROUND

Chapter 466, Hawaii Revised Statutes, regulates the practice of public accountancy in the State. The law prohibits any person, partnership or corporation from representing themselves as certified public accountants or public accountants unless they are licensed by the State. This chapter provides background information on the occupation and its regulation.

#### Occupational Characteristics

Accounting is the process of collecting, preparing and analyzing financial data and reports to provide current financial information for decisionmaking. There are three major fields of accounting: management, government, and public accounting.

Management accountants work for private firms, handling their financial affairs and internal control systems. Government accountants are involved in financial management, budget administration, or in examining the financial records of government agencies and those private organizations that are subject to governmental review. Public accountants provide services to the general public for a fee. They work as proprietors, employees, or partners of independent accounting firms. This report focuses on public accountants as they are the only accountants being regulated by the State.

Public accountants fall into two categories: (1) the certified public accountant (CPA), and (2) the public accountant (PA). Nationally, there are more than 200,000 CPAs and 20,000 PAs.<sup>1</sup> In Hawaii, there are 1,583 CPAs and 216 PAs. Of these, 1,048 CPAs and 122 PAs hold current permits to practice and are licensed to practice public accountancy.<sup>2</sup>

For the most part, both CPAs and PAs can perform the same services. CPAs differ from PAs in having met more rigorous education and experience requirements and having completed successfully the uniform CPA examination administered by the American

1. U. S. Bureau of Labor Statistics, *Occupational Outlook Handbook, 1982-83*, April 1982, p. 23.

2. State of Hawaii, Department of Commerce and Consumer Affairs, *Geographic Report*, September 1982.

Institute of Certified Public Accountants (AICPA). The PA category generally refers to those public accountants who were not CPAs and who were grandfathered in at the time statutes regulating public accountants were enacted in the various states. Most states no longer license PAs beyond those who were grandfathered.

CPAs usually concentrate in one of three major areas of public accounting: (1) auditing, (2) tax services, and (3) management advisory services. Auditing involves the examination of a client's financial records and statements and expressing an opinion on whether the financial statements fairly represent the financial condition of a firm. This is known as the attest function. Tax services involve the application of tax laws in such a manner as to allow a client the maximum financial benefits. Management advisory services involve consulting and advising clients on a variety of matters such as actuarial services, market analysis, financial management services and product analysis.<sup>3</sup>

### Regulation of Public Accountancy

Accountants achieved professional status in 1896 when New York State passed the initial law regulating accountancy by establishing the title of CPA and requiring the successful completion of a CPA examination.<sup>4</sup> Some form of licensing for CPAs is now required in all 50 states as well as the District of Columbia, Guam, Puerto Rico and the Virgin Islands.

Most states regulate public accountancy by restricting the use of the title of "CPA" or "PA" to those who have met standards for certification. Others who are not licensed may provide similar accounting, bookkeeping, and tax services so long as they do not represent themselves as CPAs or PAs.

Most states also restrict the audit or attest function to licensed CPAs and PAs as auditing is viewed as directly affecting public welfare.<sup>5</sup> Consumers, such as investors and creditors, rely on the accuracy and reliability of audited financial statements to make financial decisions. The purpose of licensing is to ensure that only those who are professionally qualified are permitted to express an opinion on financial statements.

3. U. S. Bureau of Labor Statistics, *Occupational Outlook Handbook, 1982-83*, p. 23.

4. James Don Edwards, *History of Accounting in the United States*, University of Alabama Press, 1978.

5. American Institute of Certified Accountants, *Sunset Handbook*, 1978, p. 6-5.

Federal regulation of financial reporting was initiated following the overvaluation of company assets, financial failures and the stock market crash of 1929. The Securities and Exchange Act of 1934 requires issuers of securities registered on national securities exchanges to file annual reports with the Securities and Exchange Commission (SEC). The SEC requires these financial statements to be audited by independent accountants who are registered or licensed to practice as CPAs or PAs under the laws of the place where they reside.<sup>6</sup>

In the mid-1970s the nation's major accounting firms came under heavy criticism from the SEC and the U. S. Congress. The SEC filed court and administrative charges against most of the major CPA firms for failure to detect and disclose improper accounts for overseas bribes and other questionable accounting practices.<sup>7</sup> The SEC had documented evidence of improper accounting methods, generally in connection with major business failures or businesses in serious financial difficulty, such as in the case of Lockheed.<sup>8</sup>

Hearings by the Senate Subcommittee on Reports, Accounting and Management, chaired by Senator Lee Metcalf, found an alarming lack of independence and lack of dedication to public protection in the major accounting firms. The Metcalf Committee also criticized the SEC for delegating its responsibilities for accounting standards to special interest groups.<sup>9</sup>

To a large extent, the profession has been allowed to regulate itself and it continues to do so through its professional association, the AICPA. The AICPA has become the standard setting body for the accounting profession through its numerous pronouncements on accounting and auditing which are known as generally accepted auditing standards (GAAS) and generally accepted accounting principles (GAAP). The GAAS and GAAP are the technical standards for the accounting profession which are to be followed in performing an audit and in presenting financial information.

6. Regulation S-X (17 CFR, Part 210.2-01).

7. "SEC Goes Easier on Accountants," *Wall Street Journal*, August 10, 1982.

8. "The Accounting Profession," *ProForum*, Fall 1981.

9. Hedvah L. Shuchman, et. al., *Self Regulation in the Professions: Accounting*, The Futures Groups, July 1981, pp. 2-3.

The GAAS can be described as the benchmarks to be used by accountants when exercising their judgment on the application of auditing procedures. They are the minimum standards that must be satisfied during the conduct of the audit to ensure the quality of the audit performance.

The GAAP are the standards by which accountants measure the fairness of financial reporting. The GAAP provides guidance to accountants in determining the format to be used in presenting financial information. Both federal and state authorities recognize GAAS and GAAP as standards for the profession and these pronouncements provide the basis for the regulation of auditing.

The AICPA still issues the GAAS but since 1973, GAAP has been issued by the Financial Accounting Standards Board (FASB). FASB was established in response to government pressure for an independent board for initiating accounting principles. It is separate from the AICPA and is composed of both accountants and members from the business community who are outside of the accounting profession.

Following the congressional hearings in the late 1970s, the AICPA took several steps towards self-reform, including the improvement of audit procedures and the establishment of a self-regulatory organization to implement a peer review program. Under this program, the work of CPA firms that practice before the SEC is reviewed at least once every three years.

### **Nature of Regulation in Hawaii**

**The board.** Public accountancy in Hawaii is regulated by a nine-member board placed for administrative purposes in the Department of Commerce and Consumer Affairs (DCCA). The board consists of five CPAs, two registered PAs and two public members. Both the CPAs and PAs are required to have current permits to practice. Board members serve without pay but are entitled to travel expenses. According to law, the board elects a chairman and a secretary-treasurer from among its members.

The powers and duties granted by statute to the board include the authority to: conduct examinations; grant, suspend, revoke or refuse to renew certificates, registrations, or practice permits; keep records of its proceedings; conduct investigations and hearings; adopt, amend, and repeal rules and regulations including those governing

professional qualifications and continuing education; and take other actions necessary “for the orderly conduct of its affairs and for the administration of this chapter. . . .”<sup>10</sup>

**Exemptions from regulation.** The following persons are exempt from Chapter 466: (1) CPAs or PAs without practice permits who may use their titles provided that they do not hold themselves out to be in the practice of public accountancy; (2) persons from other jurisdictions who obtain a temporary practice permit for Hawaii; or (3) persons who perform accounting functions as employees or officers of government agencies, private organizations or public accounting firms provided they do not represent themselves to be CPAs, PAs or in the practice of public accountancy.

**PAs and CPAs.** Currently, two classes of accountants, PAs and CPAs are regulated by the Board of Public Accountancy. However, the PAs are a diminishing class of accountants who will continue to decline in numbers, eventually leaving only CPAs to be licensed and regulated. Act 259, SLH 1955 which established the requirements for registration of PAs specified certain experience requirements that had to be met as of June 15, 1955 in order to assume the title of PA. A person who met the experience requirements could register with the board to be grandfathered under the law as a PA.

The legal distinction between CPAs and PAs in Chapter 466 is in title only. They may perform the same accounting duties and functions; are equally subject to specified prohibitions and sanctions; must comply with continuing education requirements; and must pay the same fees for certification or registration and permits to practice.

The law provides that only CPAs or PAs with current permits to practice may use the title CPA or PA, hold themselves out to be in the practice of public accountancy, or sign their names “to any opinion or certificate attesting in any way to the reliability of any representation or estimate in regard to any person or organization embracing: (A) Financial information, or (B) Facts respecting compliance with conditions established by law or contract, including but not limited to statutes, ordinances, regulations, grants, loans and appropriations. . . .”<sup>11</sup>

10. Section 466-4(f), HRS.

11. Section 466-10(c)(1), HRS.

**CPA requirements.** To qualify for a CPA certificate, a person must meet the following requirements: obtain a bachelor's degree with a concentration in accounting and related subjects from a college or university recognized by the board; complete 30 additional semester hours of study to be specified by rules adopted by the board; pass the national CPA examination administered by the AICPA; pass an open book examination on Chapter 466, HRS, and applicable rules; and meet specified accounting experience requirements.

An applicant who expects to obtain a degree within 120 days following the examination can apply for admission to the examination. A person successfully passing the CPA examination must subsequently complete the 30 additional semester hours and fulfill the experience requirements before a CPA certificate is awarded.

The experience requirements for CPA certification are: (1) 1,500 chargeable hours of auditing using generally accepted accounting principles and generally accepted auditing standards; or (2) two years of public accounting experience or two years of equivalent experience to be approved by the board.

Once applicants fulfill all of the education and experience requirements, they are awarded the CPA certificate and a permit to practice upon payment of appropriate fees. Both the certificate and the permit to practice are effective for two years.

**Continuing education.** The CPA certificate and the PA registration can be renewed biennially upon payment of a fee. However, in order to renew the permit to practice, the law requires CPAs and PAs to comply with continuing education requirements. The present biennial requirement is 80 hours of continuing education.

The board has adopted extensive rules covering continuing education. The rules define acceptable continuing education as a "formal program of learning which will contribute directly to the professional competence of a licensee in public practice."<sup>12</sup> The rules define hours which qualify, specify limits on certain types of qualifying hours, specify how deficient hours can be made up and carryover hours can be applied to the following year's requirement, define qualifying subjects and program requirements, specify the types of programs which automatically qualify, and define the types of programs that require approval and the requirements for obtaining board approval.

12. Title 16, Department of Regulatory Agencies, Chapter 71, Rules Relating to Certified Public Accountants and Public Accountants, Chapter 466, Hawaii Revised Statutes, Section 16-17-31.

**Temporary permits.** The statutes allow the board to issue temporary permits to practice to CPAs or PAs with valid certificates or registrations from another state or to persons having credentials to practice public accounting in a foreign country. Temporary permits are issued by the board to nonresidents who, incidental to their practice in another jurisdiction, need to practice in Hawaii. They are issued, for example, when out-of-state auditors need to audit the financial records of a local subsidiary company. Temporary permits are issued for three months or less and specify where the accountant is to practice and the scope of the work to be done.

**Public accounting corporations.** The board has adopted rules that establish certain requirements for professional public accounting corporations. A corporation providing accounting services as defined in Chapter 466, must obtain board approval for its corporate name. A corporation must obtain at least \$100,000/\$300,000 professional liability insurance coverage and register with the board to obtain a license to practice public accounting.

A corporation must file an annual report for license renewal. The report must include such information as the names of shareholders, directors, officers, and licensed employees. The report must also indicate amendments to corporate articles or by-laws and evidence of continued minimum liability insurance coverage.

**Penalties.** The board has the power to cancel, revoke, suspend, or refuse to renew certificates, registrations, or permits to practice to CPAs and PAs who are found guilty of dishonesty, deceit, or fraud in the practice of public accountancy or who have violated Chapter 466 or the rules and regulations of the board.

In cases involving disciplinary action, the board is required to give the person proper notice and a fair hearing in conformity with the State's Administrative Procedure Act of 1961. In its proceedings, the board has the power to administer oaths, compel the attendance of witnesses, require the production of documentary evidence, and examine witnesses.

Persons who are not CPAs or PAs are guilty of a misdemeanor if they (1) use the title CPA or PA in any manner to suggest that they are in the practice of public accountancy; (2) hold themselves out to be in the practice of public accounting; or (3) represent themselves as having special knowledge in accountancy for the attestation of financial information. These provisions also apply to partnerships or corporations unless each of the partners or shareholders are certified or registered with permits to practice.



## Chapter 3

### EVALUATION OF THE REGULATION OF PUBLIC ACCOUNTANCY

This chapter contains our evaluation of the regulation of public accountancy under Chapter 466, Hawaii Revised Statutes, including our assessment of the need for regulation and the effectiveness of existing regulatory operations.

#### Summary of Findings

1. Continued government regulation of auditing is warranted to protect the public from the economic harm that might result from incompetent or substandard auditing and the rendering of unreliable opinions on financial statements.

2. Other public accounting services, however, do not present the same severity of potential harm, and no regulation is needed over such services as tax preparation, estate planning, and management services. Regulation should focus only on the audit function.

3. The standards for certification and licensing of CPAs here in Hawaii are higher than those in any other state in the nation. The requirement that CPA candidates must have 30 semester hours of education beyond the bachelor's degree creates hardship for applicants with no discernible benefits.

4. The effectiveness of regulating auditing and the attest function could be improved by implementing a positive enforcement program whereby the work products of public accountants can be reviewed for incompetent or substandard performance.

#### The Need for Regulation

Although all 50 states regulate accountancy, there is considerable variation among the states in what is being regulated. Most states restrict the use of the titles "CPA" and "PA" and regulate the audit function.<sup>1</sup>

1. Oregon Legislative Research, *Staff Sunset Review, State Board of Accountancy*, October 1980, p. 6.

It is generally acknowledged that the attest or audit function is the field of accounting that should be regulated. One recent report on regulating the accounting profession states: "The state's only interest is in protecting third parties — bankers, investors, and the public — from incompetent or fraudulently prepared financial documents. Control over the expression of professional opinions on financial statements, or the attest function, is the sole basis for the entire regulatory structure."<sup>2</sup>

The public has been injured in the past by incompetent or substandard performance of the attest function by accountants. The attest function is the expression of an opinion on the fairness and reliability of information presented by business entities in their financial statements. Consumers, such as lenders and investors, rely on independent CPAs and PAs to verify the financial condition of a firm applying for a loan or offering its stock for sale.

A fraud case in 1973 involving the Equity Funding Corporation of America illustrates the economic harm to the public resulting from substandard attestation of financial reports. Although Equity Funding's financial statements had been audited annually by independent public accounting firms, fraudulent financial schemes were not detected. When Equity Funding's financial condition was eventually unraveled, it was discovered that assets were overstated by about \$185 million and that the company was in the red by about \$40 million instead of having a net worth of about \$145 million.<sup>3</sup>

A study of the case by two officials of the federal General Accounting Office (GAO), who called it "one of the biggest frauds that had ever existed in the United States," found that the intent of the fraudulent actions was to make the company look as though it were a profitable growing concern and, thus, help to keep stock prices high. The major stockholders then benefited from the high value of the stock. The three CPA firms which audited Equity Funding were sued by the trustee of the firm and accused of performing their duties negligently, failing to employ trained or reasonably skilled personnel, and making mistakes as well. The GAO officials noted that the fraud should have been uncovered had the auditors faithfully followed generally accepted

2. "The Accounting Profession," *ProForum*, Fall 1981, p. 6.

3. D. L. Scantlebury and John R. Schultz, "Lessons We Can Learn from the Equity Funding Scandal," *GAO Review*, Spring 1976.

auditing procedures. The same conclusion was reached by an American Institute of Certified Public Accountants (AICPA) Special Committee on Equity Funding.<sup>4</sup>

In the 1970s, many similar incidents of poor auditing practices led the Securities and Exchange Commission (SEC) to file charges against almost all the major CPA firms for failure to detect corporate slush funds for overseas bribes and for overlooking instances of fudged books. This resulted in the adoption of tougher standards and increased self regulation by the AICPA.<sup>5</sup>

Since auditors verify the financial condition of an entity on the basis of samples and tests of financial records and transactions, they do not guarantee the accuracy of financial statements. Rather, they render an *opinion* whether the financial statements present fairly the financial position of the entity. However, reliance can be placed on the opinion when generally accepted auditing standards and procedures are applied properly. The application of these standards is a process that requires experienced and informed judgment. State licensure is needed to provide the assurance that auditors have acquired the minimum standards of competency to render opinions upon which other parties rely.

State licensure is also needed to satisfy federal standards on financial reporting and auditing. As noted in Chapter 2, the SEC requires financial statements of publicly traded corporations to be audited by state licensed CPAs or PAs, and most federal agencies require contract auditors performing government audits to be state licensed CPAs and PAs.

In order to protect the public against substandard audits, the State must continue its regulation of the audit function and restrict the performance of the function to CPAs and PAs who are licensed by the State.

**Regulation should focus only on auditing.** While the need is evident to regulate those who perform auditing and render opinions on financial statements, regulation is not required for those who provide other accounting services. Other non-audit services, such as the preparation of tax returns, development of accounting systems, estate

4. *Ibid.*

5. "SEC Goes Easier on Accountants, Relying More on Self-Regulation," *Wall Street Journal*, August 10, 1982.

planning, financial and management advice, etc., do not present the severity of potential harm as does the audit function. These services are not restricted to licensed CPAs and PAs, and they may be provided by individuals and firms that are not regulated in any way. Of these kinds of non-audit accounting services, one sunset evaluation provides this perspective:

“Most services offered by accountants are directly consumed by their clients. Thus, the consumer has at least the opportunity to observe the service offered and to judge its quality. In addition, business people and individuals needing an accountant’s advice on [for example] estate planning can be expected to be more discerning and better educated than the general population. As a group, therefore, these clients can be expected to make comparatively well-informed judgments about the quality of service they receive from their accountants. Thus, insofar as accounting services are directly consumed by their purchasers, there is reason to have confidence that consumers can usually make intelligent choices and that the market works adequately. Furthermore, we think there is a legitimate policy question as to whether quality of service in this area is a matter the state should be guaranteeing.”<sup>6</sup>

In 1979, the Hawaii Society of Certified Public Accountants, through its Study Commission on Accountancy Law, conducted a study on licensing requirements at the behest of the Legislature. The commission concluded:

“Most CPAs perform a broad range of services in addition to the audit function. However, the Hawaii Legislature, like those in most other states, has limited the performance of only one service—the audit (attest) function—to CPAs and licensed public accountants. In view of the foregoing facts, the Commission concludes inevitably that the public’s interest in licensing the public accounting profession relates principally to the audit function.”<sup>7</sup>

If the identifiable potential public harm is substandard auditing—and there seems to be wide agreement in other sunset reviews and the current literature that this is so—then regulation should focus solely on auditing and the licensing of those who are qualified to perform it. However, current regulation in Hawaii fails to distinguish clearly between auditing and non-audit accounting services, and consequently, the purpose of regulation—to ensure competency in the performance of the attest function—has been blurred.

6. Vermont Legislative Council Staff, *Sunset Review of the Vermont State Board of Accountancy*, November 8, 1979, p. 7.

7. Hawaii Society of Certified Public Accountants, *Report and Recommendations of the Study Commission on Accountancy Law*, December 20, 1979, p. 5.

This lack of focus in regulation comes about because of two principal reasons. *First*, while many CPAs and PAs are not engaged in auditing at all but provide other kinds of services exclusively, they fall under regulation if they use their CPA and PA titles. Thus, even though the purpose of the Hawaii statute is to restrict the attest function to licensed CPAs and PAs, it reaches out to include others who are not engaged in the practice of auditing.

*Second*, because regulation reaches out beyond what is needed, qualification requirements are diluted. Thus, while the purpose of requiring experience before applicants can become CPAs should be to ensure that they have practical knowledge in the application of accounting principles and audit standards in the performance of *auditing*, the statute allows either auditing or public accounting experience. The consequence is that persons can become CPAs without ever having had audit experience.

All this leads us to the conclusion that the only compelling State interest is to license CPAs and PAs who are qualified to perform the audit function and to restrict the designations of CPA and PA to those who are qualified. With this focus, experience and continuing professional education requirements should be directly related to auditing to ensure that CPAs and PAs have the basic and continuing competency to perform auditing.

This means that new CPA candidates, in addition to meeting education requirements and passing the CPA examination, would have to meet audit experience requirements before they can be licensed as CPAs. This also means that existing CPAs and PAs would have to meet continuing professional education requirements in auditing to qualify for CPA and PA licenses.

We recognize that there may be a number of existing CPAs and PAs who are not engaged in auditing, who have no interest in continuing professional education related to auditing, but who would like to retain their titles in their non-audit practice. However, we can find no justification for the State to license such persons when the non-audit services they provide are of no concern to the State. In short, the sole focus of regulation should be on auditing, not the field of public accountancy.

## Licensing and Other Regulatory Requirements

The lack of focus in regulating only the audit function has resulted in licensing requirements that do not pertain directly to competency in auditing. Some of the requirements are also restrictive. These should be changed.

**CPA certification and permit to practice.** The minimum requirements for obtaining a CPA certificate and permit to practice include a baccalaureate degree, 30 additional semester hours, passing the uniform CPA examination and meeting experience requirements. Taken as a whole, these requirements are the most restrictive entry standards in the nation.

*Thirty additional hours.* Education requirements for CPA certification vary from state to state. Six states will accept a high school diploma, 34 states require a baccalaureate degree, the remainder will accept varying years of education beyond high school.<sup>8</sup> Hawaii is the only state that requires advanced study beyond the baccalaureate degree of an additional 30 semester hours. This requirement is both unnecessary and unfair to residents of Hawaii.

The AICPA began promoting the need for a five year education program in the early 1970s. It recommended additional education in lieu of experience requirements. These recommendations were incorporated into the AICPA's model accountancy bill. Following the AICPA's recommendations, Hawaii's accountancy law was amended in 1973 to require the additional hours and to delete the experience requirements, effective January 1, 1979.

Hawaii was the first and still is the only state in the nation to require the additional 30 hours. The amendment received support in 1973 because it was expected that most states would follow the AICPA recommendation and adopt the 30 hour requirement. This has not happened. It has been implemented only in Hawaii. Florida and Utah passed legislation that will require the additional 30 hours but not until 1983 and 1986 respectively. Colorado in 1981 amended its accounting law that would have required an additional 30 hours effective in 1983. The 30 hours will not be required but may be substituted for the one year experience requirement for CPA certification.

8. Hedvah L. Shuchman, et. al., *Self Regulation in the Professions: Accounting*, The Futures Groups, July 1981.

The primary impact of the additional 30 hours has been the added cost and hardship for CPA candidates. Students who wish to become CPAs find that they must forego employment for at least an additional year or take extended periods of leave without pay, or work full time while trying to take the courses at night school. These problems can delay students from acquiring their CPA certificates for several years. For CPA firms, the 30 hour requirement has resulted in recruitment, manpower utilization and work scheduling problems. Undoubtedly, the cost of all of this is passed on to the public.

There appear to be few benefits to balance these costs. The 30 additional hours of study do not have to be in auditing or accounting. Consequently, the requirement does not necessarily promote competency in auditing and attestation. There is no evidence that people in the other 49 states are endangered by the absence of this requirement or that people in Hawaii are better protected. The only benefit pointed out to us during our evaluation was that the 30 hours should result in better rounded individuals. However, state regulation for the purpose of developing better rounded individuals is not justifiable, desirable as this may be.

*Experience.* Almost all states require experience. The number of years required may vary depending on the educational level attained. All board members as well as others in the profession agree that experience is much more critical than the 30 additional hours for protecting the public against substandard attestation of financial reports.

The experience requirement is more closely related to competency as it requires an individual to actually work under the supervision of a licensed CPA or PA and to develop the ability to apply formal education to actual audit situations before being granted a license to practice.

The experience requirement was one year of public accounting practice between 1973 and 1979. It was dropped in 1979 when the 30 additional semester hours of education became effective. When reinstated in 1980, the experience requirement became (1) 1,500 chargeable hours of performing audits, or (2) two years of public accounting practice or two years of experience as an auditor in government or industry if such experience is substantially equivalent to public accounting practice.

The board has yet to define equivalent experience in its rules.<sup>9</sup> We suggest that it may not be appropriate to establish any equivalencies in this area. Since it is only regulation of the attest function that is needed for public protection, attestation or auditing experience should be the only acceptable experience for obtaining a permit to practice.

**Continuing professional education.** The AICPA, in 1971, began promoting mandatory continuing professional education (CPE) as a requirement for CPA license renewal. Nebraska became the first state to establish the requirement for CPE in 1971. Since then, over 30 states have implemented CPE requirements.

Act 158, SLH 1973, required CPAs and PAs to comply with CPE requirements of the board as a prerequisite for obtaining their practice permits. The board established, through rules, the requirements for CPE which became effective during calendar year 1975. Like most states, Hawaii followed the AICPA recommendation of 40 hours of CPE a year. The present biennial requirement is for 80 hours of CPE for renewal of permits to practice.

The rules adopted by the board define CPE generally as a “formal program of learning which will contribute directly to the professional competence of a licensee in public practice.”<sup>10</sup> Detailed requirements concerning CPE are spelled out in the rules. In February 1982, the board held a public hearing to revise its rules. One of the proposed revisions was to require 16 of the 80 CPE hours to be in accounting or auditing. The board took this action to force accountants to take accounting or auditing courses because according to board members, it was the only way to provide the public with some protection against substandard attestation. The board adopted the requirement, but as of the writing of this report, the new rule had not been approved by the Governor.

It is important to have continuing education requirements to ensure that CPAs and PAs are keeping up with changes in auditing standards and accounting principles. Therefore, it would be reasonable and desirable to specify a certain number of hours of

9. Although the Board adopted new rules in May 1981, these rules do not reflect changes that were made in the law in 1980. The new rules are therefore out-of-date in many respects.

10. Title 16, Department of Regulatory Agencies, Chapter 71, Rules Relating to Certified Public Accountants, Chapter 466, Hawaii Revised Statutes, Section 16-71-31.

continuing education in auditing or accounting as a requirement for the renewal of licenses of CPAs and PAs. However, there is no need to require additional hours of continuing education in other fields. The CPAs and PAs who wish to keep up with other aspects of public accountancy can do so on their own.

**Non-practice related requirements.** Applicants for certification must comply with two non-practice related requirements. As they are not germane to competency, they should be removed. The law requires applicants to be of “good moral character.” A “Certificate of Moral Character” form has been developed to establish the morality of the applicant. The board requires applicants to have these completed and signed by three persons and notarized by three persons. This is a relatively meaningless, *pro forma* exercise as most people can find three friends to vouch for them.

The application for CPA certification also includes the question, “Have you ever been convicted of a crime other than traffic violation?” This question violates the principle of Act 205, SLH 1974, which prohibits the denial or termination of employment or occupational licenses solely by reason of prior convictions.

### **Positive Enforcement Program**

Ensuring competency in auditing can be strengthened by implementing a positive enforcement program. This involves reviewing the actual work done by CPAs and PAs for conformity with accounting principles and auditing standards. Positive enforcement programs are the trend. They are being conducted in a dozen states, and other states are in the process of implementing such programs. Major accounting firms in Hawaii already have implemented a comparable peer review program but this should be instituted on a more systematic basis for all CPAs and PAs.

Positive enforcement programs have the full support of the National Association of State Boards of Accountancy (NASBA). A policy statement by the NASBA’s board of directors concludes:

“The responsibility of protecting the public from substandard practice rests squarely on the shoulders of each State Board of Accountancy. Each legislature has granted its Board the police power of the State to permit or deny entrance to the profession and to regulate and discipline licensees because the legislature was convinced that public welfare and safety demanded such laws.

“In the past, State Boards typically relied on complaints from fellow licensees, state audit agencies, or clients to find out about substandard work. Although these avenues of discovery must continue, it has become evident that positive steps and not merely reactive steps are most likely to disclose substandard work and reduce it to a minimum so that, as State Boards, we meet our obligation to protect the public interest.

“Therefore, it is the recommendation of NASBA that a formalized program of Positive Enforcement be adopted in all jurisdictions.”<sup>11</sup>

The NASBA has developed a positive enforcement manual for state boards of accountancy to use in implementing such a program. The manual provides instructions on all aspects of a positive enforcement program including means of financing, selection of reviewers, selection of work products for review, review procedures, communication with practitioners on the results of review, and sanctions. It also includes a description of the programs currently being carried out in four states.

The results of positive enforcement in certain states indicate the need for a peer review program. The Arizona Board of Accountancy performed 26 quality reviews of audit reports of Arizona public agencies. Nine of these reviews disclosed deficient audit work which resulted in disciplinary action by the board against the licensees.<sup>12</sup>

The Oregon State Board of Accountancy has reviewed the quality of financial statements prepared for certain state agencies. Reviews of these statements against GAAS and GAAP showed that a substantial percentage of these financial statements are substandard. In 1980, almost 37 percent were deficient in various respects.<sup>13</sup>

The Hawaii Board of Accountancy has a copy of the NASBA manual that it can utilize in implementing a positive enforcement program. The Board should begin plans to initiate such a program. In doing so, the board should solicit the assistance of the Hawaii Society of Certified Public Accountants.

11. National Association of State Boards of Accountancy, *Positive Enforcement Manual for State Board of Accountancy*, prepared by the Committee on Surveillance and Enforcement, September 1982.

12. Arizona Auditor General, *A Performance Audit of the Arizona State Board of Accountancy*, August 1979.

13. Oregon Legislative Research, *Staff Sunset Review*, October 1980.

## Complaints

There have been relatively few complaints filed with the Board of Accountancy. In calendar year 1981, there were a total of only 13 complaints. Of these, eight were dismissed for lack of evidence or because there was no violation of the law. The remainder were complaints against non-CPAs and non-PAs who had used the term “accounting” or “accountant” in advertisements or in their business cards.

The board has taken a position that the use of these terms violates Section 466–10, HRS, which prohibits any person, partnership, or corporation from using the titles CPA, PA or any other designations that might be confused with these titles unless they have a permit to practice.

After these complaints were investigated, the board, through its executive secretary, sent letters of admonishment to respondents saying that they could be found guilty of a misdemeanor and that their conviction shall be subject to a fine of not more than \$1000 or imprisonment of not more than one year or both.

Generally, the respondents have replied with letters of apology to the board and have agreed to comply with the board’s demand that they delete the terms accounting or accountant from their advertisements or business cards. However, in one instance, the respondent defended his right to use the term based on court rulings in other states. The board chose not to pursue the case and referred it to the Office of Consumer Protection.

It is not clear that the board has the authority to issue these letters of admonishment. We understand that the board was once advised orally by a deputy attorney general that the use of the terms does not violate the law. The DCCA investigators vary in their interpretations of the law and whether respondents using the terms accounting or accountant are actually in violation of Section 466–10.

Use of generic terms, such as accounting and accountant, has also been an issue in other states. One of the cases in this controversy was a complaint filed by the Maryland State Board of Accountancy which charged a firm named Comprehensive Accounting Service Company with violation of their accountancy statute which restricted the use of the terms accounting, auditing, accountant, and auditor. The Maryland Court of Appeals overturned the injunction against the firm noting that the law was contradictory in that it did not prohibit unlicensed accountants from practicing; it merely prohibited them

from describing these services in the most understandable terms. The court arrived at the conclusion that if the law allows unlicensed individuals to function as accountants, then they certainly should not be restrained from using the most appropriate generic terms to describe their work.<sup>14</sup>

Since the public is not endangered by non-audit accounting services, there is no need for the board to police the use of generic terms by those who provide such services, just so long as such persons do not also represent themselves to be CPAs or PAs.

### **Conclusion**

Our evaluation of the regulation of public accountants shows that there is a continued need to regulate the attest function under Chapter 466, HRS. However, amendments are needed in the law and the rules to restrict the licensing of CPAs and PAs to those who are qualified to perform the audit function and to relate experience and continuing education requirements to auditing. Our specific recommendations follow.

### ***Recommendations***

*We recommend the following:*

1. *Chapter 466, HRS, be modified so that only those who are qualified to perform auditing are licensed as CPAs and PAs.*

2. *Chapter 466, HRS, also be amended to require experience to be experience in auditing as a qualification for CPA licensing, and continuing professional education to be education in accounting and auditing as a condition for renewal of CPA and PA licenses.*

3. *Even if Recommendations 1 and 2 are not enacted, amendments be made to the law to provide for the following:*

a. *Eliminate the requirement for 30 additional semester hours of upper division or graduate study as a qualification for CPA certification and permit to practice.*

b. *Delete the requirement that applicants be of good moral character.*

14. Al Hargraves and W. Elbert Jones, "Use of Generic Titles by Unlicensed Accountants," *CPA Journal*, December 1979.

4. *The board, with the assistance of the Hawaii Society of Certified Public Accountants, proceed to implement a positive enforcement program.*

5. *The board and the Department of Commerce and Consumer Affairs cease sending letters of admonishment or investigating cases where non-licensed persons use such generic terms as “accountant” or “accounting” to describe their services, just so long as the persons do not also represent themselves to be CPAs or PAs.*

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**APPENDIX**  
**RESPONSES OF AFFECTED AGENCIES**

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## COMMENTS ON AGENCY RESPONSES

A preliminary draft of this Sunset Evaluation Report was transmitted on December 17, 1982 to the Board of Public Accountancy and to the Department of Commerce and Consumer Affairs for their review and comments. A copy of the transmittal letter to the board is included as Attachment 1 of this appendix. A similar letter was sent to the department. The responses from the board and the department are included as Attachments 2 and 3.

The board disagrees with some of our recommendations and agrees with others. The most basic disagreement is over the extent to which the state should regulate accounting practices which do not involve auditing. Our evaluation concluded that only auditing requires regulation and that only those who are qualified to perform audits be licensed as certified public accountants and public accountants. The board disagrees on the basis that the work of licensees involves more than auditing.

The board also disagrees with our recommendation that experience and continuing education requirements be related to auditing and accounting as a condition for licensing, because it believes that public accountants need to maintain knowledge beyond accounting or auditing. This disagreement stems from the more basic disagreement as to what should be regulated and who should be licensed. As stressed in our report, it is only the attest or audit function that should be regulated in order to protect third party users from incompetent or fraudulently prepared financial statements; therefore licensing should be restricted to those who meet qualifications to perform audits, and experience and continuing education requirements should relate to and promote the competency to perform audits by such practitioners. While non-audit experience and non-audit continuing education programs may contribute to the overall professional experience of the licensees, these need not be regulated by the State but should be at the option of the practitioner.

The board disagrees with our recommendation to delete the requirement that applicants be of good moral character and it maintains its right to investigate a licensee's moral and ethical character. The board believes that our report shows a total disregard for the need for morality and ethics in the accounting profession. Not so. We merely

find that the board's present requirements provide no assurance of good moral character and are a relatively meaningless exercise.

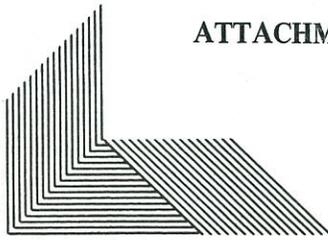
The board agrees with our recommendation that the 30 additional hours of education beyond the baccalaureate degree be eliminated. The board also agrees with our recommendation that it cease sending letters of admonishment or investigating cases where non-licensed persons use generic terms, such as "accounting" or "accountant," to describe their services.

Finally, the board endorses our recommendation that it implement a positive enforcement program although it is concerned with funding for such a program. As we pointed out in the report, positive enforcement programs are being implemented in about a dozen states. Varying sources of funding, such as licensee fees, are being used as well as volunteer help. We advocate, for example, that the board seek the cooperation and assistance of the Hawaii Society of Certified Public Accountants in establishing a positive enforcement program. A manual, prepared by the National Association of State Boards of Accounting, on how to implement a positive enforcement program and how such a program could be financed is available to the board.

The Department of Commerce and Consumer Affairs responds that it is in agreement with our recommendation to delete the 30 additional semester hours of upper division or graduate study as a qualification for licensing and to dispense with the requirement that applicants be of good moral character. However, contrary to the board's response, the department does not agree with our recommendation that it cease investigating complaints and sending letters of admonishment to unlicensed persons using the terms "accountant" or "accounting" to describe their services.

ATTACHMENT 1

THE OFFICE OF THE AUDITOR  
STATE OF HAWAII  
465 S. KING STREET, RM. 500  
HONOLULU, HAWAII 96813  
(808) 548-2450



CLINTON T. TANIMURA  
AUDITOR  
~~HAWAIIAN~~  
DEPUTY AUDITOR

December 17, 1982

C O P Y

Mr. Efrain Andrews, Chairman  
Board of Public Accountancy  
Department of Commerce and Consumer Affairs  
State of Hawaii  
Honolulu, Hawaii 96813

Dear Mr. Andrews:

Enclosed are 10 preliminary copies, numbered 4 through 13, of our *Sunset Evaluation Report, Public Accountancy*. These copies are for review by you, other members of the board, and your executive secretary. This preliminary report has also been transmitted to Dr. Mary G. F. Bitterman, Director, Department of Commerce and Consumer Affairs.

The report contains our recommendations relating to the regulation of public accountancy. If you have any comments on our recommendations, we would appreciate receiving them by January 17, 1983. Any comments we receive will be included as part of the final report which will be submitted to the Legislature.

Since the report is not in final form and changes may possibly be made to it, access to this report should be restricted solely to board members and those officials whom you might wish to call upon to assist you in your response. We request that you exercise controls over access to the report and ensure that the report will not be reproduced. Should you require additional copies, please contact our office. Public release of the report will be made solely by our office and only after the report is published in its final form.

We appreciate the assistance and cooperation extended to us.

Sincerely,

Clinton T. Tanimura  
Legislative Auditor

Enclosures

ATTACHMENT 2



GEORGE R. ARIYOSHI  
GOVERNOR

MARY G. F. BITTERMAN  
DIRECTOR

DICK H. OKAJI  
LICENSING ADMINISTRATOR

BOARD OF ACCOUNTANCY

STATE OF HAWAII  
PROFESSIONAL & VOCATIONAL LICENSING DIVISION  
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

P. O. BOX 3469  
HONOLULU, HAWAII 96801  
January 17, 1983

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OFF. OF THE AUDITOR  
STATE OF HAWAII

Mr. Clinton T. Tanimura  
Legislative Auditor  
The Office of the Auditor  
State of Hawaii  
465 South King Street, Rm. 500  
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

We have reviewed the preliminary draft of the Legislative Auditor's Sunset Evaluation Report for Public Accountancy. We would like to commend your staff for the thoroughness of the report and the in-depth research that supported their conclusions. We do, however, feel that certain portions of the report requires our comments and observations. In this regard, the following is our response. We thank you for the opportunity to review and respond to your sunset review of the Public Accountancy Law.

We believe that Public Accounting is a profession that requires the licensed practitioner to maintain a certain level of knowledge that extends beyond accounting or auditing. According to Carey in "The Rise of Accounting Profession" on page 3, "The seven criteria which distinguish professions from other pursuits are: (1) a body of specialized knowledge; (2) a formal educational process; (3) standards governing admission; (4) a code of ethics; (5) a recognized status indicated by a license or specialized designation; (6) a public interest in the work that the practitioners perform; and (7) recognition by them of a social obligation." It is our contention that the experience requirements and the continuing education requirements will assist in accomplishing these criteria. To require only accounting or auditing would be detrimental to both the public and the profession. In other words, we believe that your recommendation to require regulation only in auditing needs to be clarified. There are many small businesses who publish financial statements that contain compiled or reviewed reports prepared by accountants. These types of reports are noted by you as "non-audits". These reports are relied upon by many third-party users, especially financial institutions. To regulate the audit function and not the "non-audit" functions of the profession would be extremely detrimental to the public's well-being.

We further believe that the requirement for a licensee to have 30 credit hours beyond the baccalaureate degree is proper. Although this principle has been widely accepted throughout the profession, Hawaii is presently the only state with this requirement. This places an undue disadvantage on our youth. Secondly, our major institutions for higher learning have not been able to accomodate the demands for all who are required to obtain the additional 30 credit hours. Until this requirement has been implemented by other states and until our universities can provide the resources to obtain the additional hours of learning, we feel that it makes no sense for Hawaii to be the only state in the nation to require the additional hours of study. We would like to emphasize that although we are suggesting that the 30 credit hour requirement be eliminated, we still support the principle of the additional hours of study.

We would like to mention the fact that we have recommended to the Governor that this requirement be changed in accordance with your recommendation and that he request the legislature to do so.

An important aspect to the report is the seemingly total disregard for the need for morality and ethics in our profession. Reading the report as such, it would seem that we again refer to the professional needs of a public accountant. There is no way we can anticipate that we would be able to operate and expect to maintain a professional environment if we do not have the right to investigate a licensee's moral and ethical character. The only purpose of our program and requirements for our seeking out criminal records is to fulfill this aspect of our responsibility. We realize there may be a conflict between our inquiring whether a person has a criminal record; however, we know of no other way to determine this. If there is a conflict with another law, we would like to suggest that that law be changed.

Our comments regarding your recommendations made in the report are as follows:

1. We do not feel that this is a sound recommendation because the work of the licensed practitioner involves more than just auditing. There is a substantial amount of work in the "non-audit" area as noted above.
2. For the same reasons as noted above, we feel that audit and non-audit type practices will contribute to the professional experience of the licensee. In addition, we sincerely believe that it is important to include a broad base of programs in our continuing education program, which should include a certain number of hours that pertain to the attest function, namely accounting or auditing.
- 3.a. We agree with your recommendation to eliminate the 30 hour requirement, only because of the practical aspects of the current laws throughout the U.S. and of the inability of

many prospective licensees in obtaining the additional hours of study. We still believe that the philosophy of education beyond the baccalaureate degree is proper.

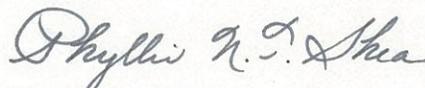
- b. We believe that the requirements that a licensee be of good moral character and subscribe to established rules of ethics are basic to the profession and that we disagree with this recommendation. It is particularly important that we express the fact that if it is our responsibility to protect the public in the field of public accounting, it is necessary that we have adequate information to satisfy ourselves that the public accountant is of good moral character.
4. We endorse this recommendation. However, the implementation of such a recommendation will require funding that the Board does not have. Although we would expect the licensees to be responsible for the maintenance of the enforcement program, the implementation of the program, which would require policing, could have some extensive costs.
5. We do not anticipate any problems in following this recommendation.

Again, we thank you for the opportunity to respond to your comments, observations and recommendations. We would also like to thank you and your staff for supporting the work of the Board and seeking its continuance.

We remain,

Sincerely,

STATE BOARD OF ACCOUNTANCY



Phyllis Shea, Chairman

ATTACHMENT 3

GEORGE R. ARIYOSHI  
GOVERNOR



STATE OF HAWAII  
OFFICE OF THE DIRECTOR  
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS  
1010 RICHARDS STREET  
P. O. BOX 541  
HONOLULU, HAWAII 96809

MARY G. F. BITTERMAN  
DIRECTOR  
Commissioner of Securities  
Bank Examiner

DONALD D.H. CHING  
DEPUTY DIRECTOR

January 17, 1983

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OFF. OF THE AUDITOR  
STATE OF HAWAII

The Honorable Clinton T. Tanimura  
Legislative Auditor  
State of Hawaii  
465 South King Street, Room 500  
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

Thank you for the opportunity to comment on your sunset evaluation report on public accountancy.

The Department of Commerce and Consumer Affairs is in agreement with the Auditor's recommendations that the Board of Accountancy (1) delete the 30 additional semester hours of upper division or graduate study as a qualification for CPA certification and permit-to-practice and (2) dispense with the requirement that applicants be of good moral character.

The department does not agree, however, with the Auditor that it cease the practice of investigating complaints and sending letters of admonishment to non-licensed persons using such generic terms as "accountant" and "accounting" to describe their services.

Sincerely yours,

Mary G. F. Bitterman  
Director