

October 31, 2013

The Honorable Joan Carter Conway, Chair
Senate Education, Health, and Environmental Affairs Committee
Miller Senate Office Building, 2 West Wing
11 Bladen St.
Annapolis, MD 21401


The Honorable Dereck E. Davis, Chairman
House Economic Matters Committee
House Office Building, Room 231
6 Bladen St.
Annapolis, MD 21401

Dear Chair Conway and Chairman Davis:

I herewith transmit on behalf of the Department of Labor, Licensing and Regulation and the State Board of Accountancy, the follow up report required by Chapter 212 of the Laws of 2013 and specified in the 2012 Preliminary Evaluation of the State Board of Public Accountancy published November 27, 2012.

Should you or any of your committee members have questions or concerns regarding this report, please contact the Board's Executive Director, Dennis Gring, by telephone at (410) 230-6224 or by e-mail at dgring@dllr.state.md.us.

Sincerely,


Michael Vorgetts
Acting Commissioner

cc: Leonard J. Howie III, Secretary
Thomas J. "Tim" Murphy, Chair
Dennis Gring, Executive Director
Sara Fidler, Committee Analyst
Laura Atas, Committee Analyst

**FOLLOW-UP REPORT TO THE SENATE EDUCATION, HEALTH AND
ENVIRONMENTAL AFFAIRS COMMITTEE AND THE HOUSE ECONOMIC
MATTERS COMMITTEE**

Uncodified language included in Chapter 212 of 2012 required the State Board of Public Accountancy, in conjunction with the Department of Labor, Licensing and Regulation (DLLR), to submit a follow-up report to the Senate Education, Health, and Environmental Affairs Committee and the House Economic Matters Committee to address several issues identified in the 2012 Sunset Evaluation of the State Board of Public Accountancy conducted by the Department of Legislative Services (DLS). This report addresses the issues raised in Chapter 212 and the evaluation report.

The Enforcement of the Peer Review for Licensees and Firms.

In October 2008 individual certified public accountants (CPAs) and CPA firms were required to affirm the completion of a peer review on license or permit renewal applications as a condition for license or permit renewal. A peer review is a triennial evaluation of CPAs and CPA firms. Conducted by an independent CPA, a peer review examines a CPA sole practitioner's or CPA firm's quality control procedures in providing accounting and auditing services ("peer review mandated services") to the public. Peer reviews are conducted in accordance with the Standards for Performing Peer Reviews established by the American Institute of Certified Public Accountants (AICPA) or standards equal or greater than those of the AICPA. The Board has approved the peer review programs of the Maryland Association of Certified Public Accountants and AICPA-affiliated associations (societies) in other states to provide peer review services to Maryland licensees and permit holders.

At the time of license or permit renewal, an individual CPA or CPA firm must advise the Board whether the individual or firm provides peer review mandated services to the public. If peer review mandated services are provided, the individual CPA or firm must advise which Board-approved peer review program supervised the peer review, the type of peer review (system or engagement), and the date the peer review was accepted by the peer review program. Peer review programs are required to report individuals or CPA firms that receive a rating of fail or a second consecutive pass with deficiencies to the Board.

During the period 2008 to 2012 the Board created a Peer Review Oversight Committee (PROC) to work with the Maryland Association of Certified Public Accountants (MACPA) to develop the process for reporting peer review failures, assess the nature of the failures and determine the level of sanctions the Board should impose in the event of reports of peer review failures. The PROC routinely filed progress reports at the Board's business meetings.

In February 2013 the MACPA submitted its initial report to the Board concerning peer reviews conducted for Maryland CPAs and CPA firms. This report established a baseline for evaluating the performance of CPAs and CPA firms in preparation for formal reporting of peer review failures to the Board. The MACPA conducted the following number of peer reviews for the years 2010, 2011, and 2012:

YEAR	REVIEWS
2010	267
2011	251
2012	289

Source: Maryland Association of Certified Public Accountants Peer Review Report, February 2013

The following chart shows the number of peer reviews conducted by the MACPA and the results of the review:

YEAR	PASS	PWD	FAIL	TOTAL	% FAIL
2010	243	18	6	267	2%
2011	194	35	22	251	9%
2012	225	40	24	289	8%

Source: Maryland Association of Certified Public Accountants Peer Review Report, February 2013

In 2013 the Board established a quarterly reporting cycle where MACPA reports peer review failures or second pass with deficiencies. In April the MACPA formally reported 60 individual CPA or CPA firm peer review failures. In July, the MACPA reported three individual CPA or CPA firm peer review failures. To date, MACPA has not reported CPAs or CPA firms that have received a second fail or a second pass with deficiencies. Upon receipt and review by the Board, “warning” letters were sent to the 63 CPAs/CPA firms reported by MACPA as receiving a failing peer review. Formal administrative action takes the form of prescribing continuing professional education (CPE) in areas of deficiency; or a reprimand, suspension, revocation and/or civil penalty if an investigation reveals technical competence issues.

To understand the utility of a peer review it must be noted that peer reviews only evaluate a small sample size of audit or financial statement services that are provided by a CPA or a CPA firm. The Board cannot draw a definitive conclusion about a CPA’s or a CPA firm’s overall practice from such a small sample size. A more thorough investigation into a CPA’s/CPA firm’s standards of practice is required. Additionally, peer reviews are essentially “educational” in nature, designed to identify the strengths and weaknesses in the operation of a CPA or CPA firm. Its purpose is to help CPAs and CPA firms improve their practices to meet or exceed the standards required for the type of financial statements that are provided to their clients. The Board takes this into consideration as it evaluates a report of a peer review failure.

The vast majority of first time peer review failures do not warrant formal administrative action and are correctable by the continuing professional education prescribed by the peer review program. The Board, however, issues a formal advisory letter. The letter informs the CPA or CPA firm that the Board is aware of the peer review failure; the importance of complying with the remedial training prescribed by the peer review program; requests the CPA or CPA firm to conduct a self-assessment of the services that are provided and whether they desire to continue providing those services; and warns that a subsequent peer review failure may result in formal administrative action.

The Management of the Certified Public Accountancy Fund

On July 1, 2007, the Board transitioned to special fund status and now administers the State Board of Accountancy Fund. In September 2008 the Board established a fee schedule for license applications, permits, and other services designed to raise enough revenue to pay for its direct and indirect costs, expand and improve services to its licensees, hire staff to provide expanded services, upgrade its information technology infrastructure, and create a prudent surplus to withstand any unexpected increase in expenditures or significant decrease in revenue. In considering its initial new fee schedule the Board examined the following factors:

Direct costs: Expenditures such as staff salaries and benefits, equipment, mileage, travel and National Association of State Boards of Accountancy (NASBA) dues;

Indirect Costs: Expenditures relating to legal services, departmental and division services, rent, and other general services costs; and

Information Technology Innovations: Expenditures on projects designed to enhance licensing and examination processing and digital record keeping.

Since a substantial portion of revenue is generated by active license renewals the Board had to take into consideration attrition (non-renewals), the replacement rates for new licensees, as well as the potential negative effect of legislation to ease the requirements of interstate practice of certified public accountancy (mobility) on license renewals. As a result, the Board adopted a fee schedule doubling the renewal fees for licenses/permits and services. This increase returned the Board's fee structure to pre-1996 levels. The General Assembly at that time reduced Board fees by 50%.

In fiscal year 2012 the Board, in recognition of the significant and rising balance of the fund, reduced most fees by 37.5%. The reduction in fees began on June 1, 2012. The fund balance accrued beyond the Board's initial expectations because the anticipated attrition of licensees due to mobility did not occur. The Board maintains stable level of licensees/permit holders, more than 20,000 annually. Deferrals in expenditures due to delays in launching internet-based services and vacancies in staff positions contributed to the rate of growth in the fund's balance. Thus, the Department and Board determined it advisable to reduce its fees.

Board Plans Significant Technological Upgrades

The information technology master plan for the Board, envisioned in 2008 when fees were initially increased, has not been fully implemented. However, a significant project is scheduled to be launched in fiscal year 2014. This e-commerce project, which is expected to be available in November 2013, will enable individuals to file, update, and track the progress of their examination and license applications online. They will not have to file paper applications, call or email the Board to obtain a status of their application. In spring 2014, it is expected that qualifying experience endorsements for active CPA licensure will be able to be filed online, further reducing the reliance on paper forms. The Board is spending \$140,000 to launch these projects.

Additionally, the Board has earmarked funds to replace the honor system of reporting of continuing professional education ("CPE"). Now, the license renewal application permits licensees to simply indicate the number of CPE earned. The Board audits five percent of

licensees who report CPE. The Board plans to replace this method of reporting CPE with real-time online posting of the CPE that a licensee earns. This process will be similar in scope to electronic banking. It is estimated that the cost of this project is approximately \$50,000. The launch of this project is expected in FY 2015.

The Board is also focusing on digital record keeping of examination and licensing files. Documents that support an examination applicant's transcripts and relevant documents, and records to support a license or permit application are prime candidates for archiving through digital media. The estimated cost of this project is approximately \$60,000.

The Board is always looking for ways to adapt e-commerce and other technological innovations to improve its daily operations and to provide services to its licensees, applicants, and the public. Its vision is driven by the technological sophistication of the CPA industry. CPAs, especially younger professionals, have embraced these innovations to conduct business and communicate with each other as well as reach out to the Board. The Board must be positioned to keep up with the technological savvy of its customers.

Fund Balance Declining

A prudent balance in the fund is essential. Licensee attrition, due to the ease of interstate practice of certified public accountancy, may still occur. Efforts are being made by the CPA industry to ease or eliminate state firm permit requirements (firm mobility). The Board must remain prepared for a sudden, unexpected drop in the number of licensees. The Board must also be cognizant that there may come a time that a case of alleged, and significant, licensee or CPA firm misconduct requires its attention, resulting in expenditures for investigators, experts and litigation services. For example, in 2003-2005, the Texas Board of Accountancy spent over \$1 million to investigate and prosecute a complaint concerning CPAs involved in the Enron scandal and the CPA firm Arthur Anderson.

As of July 1, 2013, the balance in the Fund was \$958,000. In analyzing the future expenses and revenues, as well as the sustainability of the fund to support its services, the Department has reviewed anticipated revenues from license renewals; trends in new licensee and permit holders; and projected its direct and indirect expenditures relating to its planned information technology innovations. If the fee schedule remains the same and current license levels remain constant, the Fund will decrease each year. Thus, the Board needs to consider a graduated increase in fees beginning in Fiscal 2015 to avoid a potential negative fund balance by mid-FY 2018.

Since the Board is limited by law to a 12.5% annual increase in fees, the initiation of fee increases must be implemented several years in advance and sustained to mitigate a shortfall in the Fund. In order to ensure the Fund balance through fiscal year 2024, with a prudent surplus for emergencies, the Board needs to increase fees in future years. The Department's and the Board's staff has examined several strategies to adjust the Board's fees:

1. increasing fees by the 12.5% for fiscal years 2015 through 2018;
2. increasing fees by 10.0% for fiscal years 2015 through 2020; and
3. increasing fees by 8.0% for fiscal years 2015 through 2023.

General Economic Assumptions:

- the number of license and permit renewal applications will remain consistent with historical rates;
- new licensees and permit holders will continue to offset those who do not renew;
- the increase in direct and indirect costs is projected to be 3% annually;
- the Board will maintain full staffing;
- the Board will maintain its level of services; and
- the Board will continue its information technology master plan to convert from manual paper processes to e-commerce solutions to the filing of applications and support documents.

Option 1 - Increasing fees by the 12.5% for Fiscal Years 2015 through 2019.

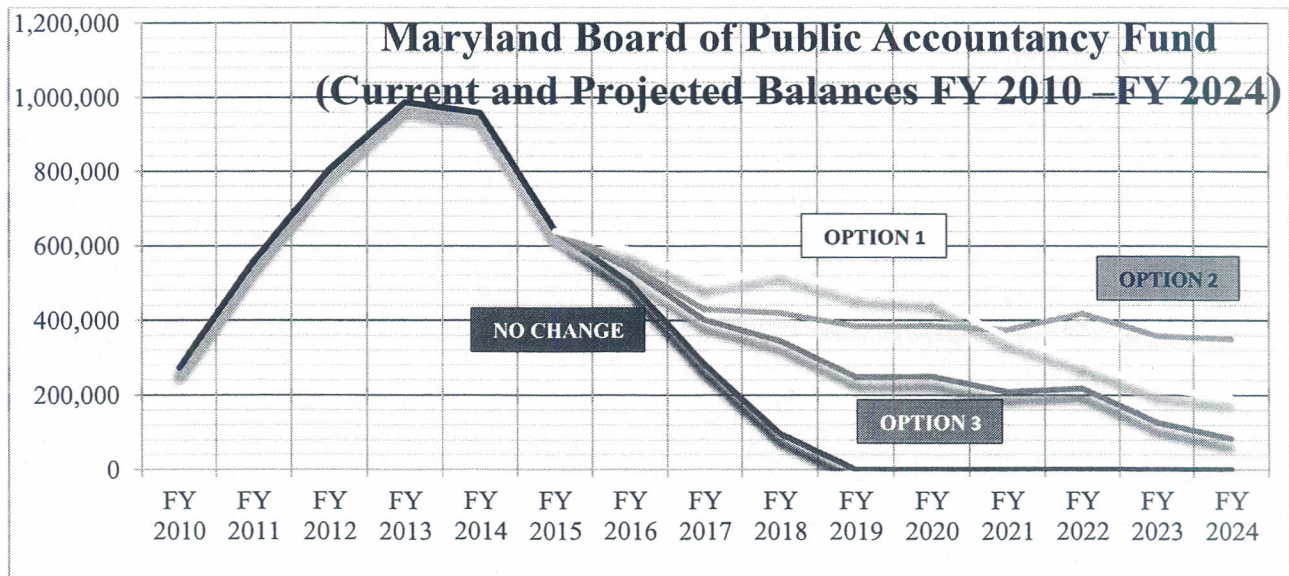
Initiating a 12.5% increase in fees at the beginning of fiscal year 2015 (July 1, 2014) and increasing the fees at the beginning of each fiscal year through 2019 would permit the Board to accrue a fund balance averaging \$500,000 by fiscal year 2020 and sustain that balance through at least fiscal year 2023.

Option 2 - Increasing fees by the 10.0% for Fiscal Years 2015 through 2020.

Initiating a 10.0% increase in fees at the beginning of fiscal year 2015 (July 1, 2014) and increasing the fees at the beginning of each fiscal year through 2020 would permit the Board to accrue a fund balance of at least \$294,236 by fiscal year 2020 and sustain that balance through at least fiscal year 2023.

Option 3 - Increasing fees by the 8.0% for Fiscal Years 2015 through 2023.

Initiating an 8.0% increase in fees at the beginning of fiscal year 2015 (July 1, 2014) and increasing the fees at the beginning of each fiscal year through 2020 would result in a fund balance of at least \$250,000 in fiscal year 2020. The balance would progressively dip to less than \$85,000 by the beginning of fiscal year 2024.



Source: Department of Labor, Licensing and Regulation

These three options present current and future Boards with numerous strategic choices to establish a fee structure to sustain it level of services, to continue innovation of its office processes, and maintain a workable fund balance. The Board will be considering the necessity of adjusting its fees to address the sustainability of the Fund beginning in November 2013.

Examination of Outsourcing the Application Review for Candidacy for the Uniform CPA Examination

The Department was requested to examine outsourcing the education qualification review process for applicants for the Uniform CPA Examination. In the request, the DLS evaluation report asked that the Department consider the services of the NASBA education evaluation program to provide these services to examination applicants in lieu of the Board. It also suggested that the Department consider NASBA as a sole source vendor.

In examining this issue, the Department looked at the following:

- the efficiency of current staff operations;
- current investment in e-commerce applications to further streamline the application process;
- the value to and economic benefit for examination applicants;
- impact of outsourcing on current staff operations; and
- the reality of a sole source designation in this process.

Staff is efficient in processing applications

Current staff has more than 13 years of experience in evaluating the education credentials of examination applicants. Staff is assisted by the education member of the Board, who teaches accounting at a Maryland college or university. Most issues involving questions of a candidate’s eligibility for the Uniform CPA Examination are resolved locally, usually in the applicant’s favor, and do not require the consideration of the entire Board. The staff has been able to successfully manage the significant increase in applications received due to the easing of the requirements for examination eligibility in October 2011. In 2012 applications increased by 26.7%. In 2013 applications filed with the Board decreased by 11.7% from 2012. In the year ending September 30, 2013, 93.3% of applications were processed within 30 days. The Board was able to maintain its efficiency despite two staff vacancies for a substantial portion of 2013.

PERCENTAGE OF APPLICATIONS PROCESSED

(Cumulative percentage of applications processed by 5 calendar-day intervals)

NO. OF DAYS	% PROCESSED
FIVE	40.1%
TEN	66.3%
FIFTEEN	79.4%
TWENTY	85.4%
TWENTY FIVE	90.4%
THIRTY	93.3%

Source: Department of Labor, Licensing and Regulation

The remaining 6.6 % of applications were completed after staff involvement to facilitate the receipt of documents and information to clarify the eligibility of course work submitted by the applicants.

Investment in e-commerce examination applications

The Department and the Board has invested a significant amount of funds in information technology to streamline the examination application process and other licensing applications. The Board has spent \$130,000 in the development and implementation of the online CPA Examination application. The Board eliminated the manual paper filing in favor of an e-commerce solution through the Department's website. Instead of filing a paper application, applicants complete an online application. By November 2013, applicants will soon be able to check the progress and status of their application online, supplement the academic credentials of a filed application, change their street and email addresses, and telephone numbers directly online. The Board has also invested in back end technology so that staff can process and monitor these applications.

The current process provides value and personal service to applicants

The Uniform CPA Examination is one of the most expensive professional credentialing assessment instruments in the world. The base cost for the four examination sections of the examination averages \$800.00. A survey of the current fees charged to file an initial examination application with other state boards of accountancy show a mean cost of \$131.00. Currently, the cost to applicants to file an examination application to the Board is \$60.00. The lowest initial examination application fee is \$10 (West Virginia). Only five other states (Arkansas, Florida, Oklahoma, Texas, and South Dakota) charge fees less than Maryland. The highest initial application fee is \$230 (North Carolina). Some accountancy boards charge an additional fee to submit a retest application. Other accountancy boards require applicants to file the examination section fee(s) at the time the initial qualification application is filed. The Maryland Board requires only the one-time \$60.00 application fee. A candidate only pays the examination section fee(s) after the applicant is qualified to take the examination. Once qualified for examination candidacy, a Maryland applicant does not have to pay any additional fee, other than the examination section fee, to retake a failed section of the examination.

Additionally, examination reviews are conducted locally. Applicants have access to Board staff, and by extension, the Board's educator member to resolve questions of candidate eligibility. Applicants have the opportunity to visit personally with Board staff to facilitate the processing of their application.

The timely processing of applications, the local and personal staff service to assist individuals to qualify for the exam, and the relatively inexpensive \$60.00 application fee provides Maryland CPA Examination candidates significant value.

The impact of outsourcing

The Board of Public Accountancy has consolidated its processing of each element of a licensing file in-house: the initial examination application; the review and approval/denial

checklist; the examination registration logs; the examination performance history; the education review for licensure; the report of qualifying professional experience; and a certificate of the completion of a professional accounting ethics course. All of these component documents constitute an individual's licensing file and are maintained in one place.

The initial application for CPA Examination candidacy is also the first part of the application for licensure. The \$60.00 examination application fee is equivalent to the fee charged to applicants for a reciprocal application or a transfer of examination grades for Maryland CPA licensure from other state. The application fee to review qualification for active CPA licensure is \$60.00. The license fee is an additional \$20.00. All initial application fees are deposited in the Board of Accountancy Fund.

The cost to an applicant would increase in the event the Department outsources the examination evaluation process. The Board would still require the collection of the \$60.00 initial application fee, otherwise it would result in a decrease of approximately \$60,000 in revenue to the CPA Board Fund. The compensation to a separate vendor, per examination application, would have to be added to the Board's application fee. The cost to applicants for an initial examination application would, inevitably, increase.

Security of college transcripts and other personal candidate data would also be of concern. Currently, all of this personal data is secured at the Board's offices at the Department's facilities. The documents pertaining to the initial application would require the ultimate transfer of those documents to the Board's possession for inclusion to the master file for the applicant and potential licensee. A document transfer protocol would have to be established to submit applicant files to the Board.

Outsourcing the examination qualification review process has the potential to increase the number of examination appeals considered by the Board. All applications are subject to review by the Board. This review is done on a routine daily basis at this time. Each examination applicant has the right to appeal a denial of the application to the Board. A vendor's review of an examination application is more likely to result in a denial appeal request than a denial that is the result of a staff review. The Board, as a whole, has considered few examination denial appeals under the current process.

One other consideration is the review of educational credentials to meet the requirements for licensure. As has been indicated, beginning in October 2011, an individual can qualify for CPA Examination candidacy with an educational background less than that required for a license. Prior to October 2011, a person was required to meet the education requirement for licensure before being approved for candidacy for the CPA Examination. Now, a person can qualify for examination candidacy but not for a license. The only requirement for qualification for the CPA examination is a degree in accounting, or the equivalent of a degree in accounting, and by completing at least nine courses in accounting and one course in ethics as specified in Code of Maryland Regulations (COMAR) 09.24.05.03 (a). At a later date, a person can meet the education requirements for a CPA license by completing at least 30 semester hours of additional course work, including courses specified in COMAR 09.24.05.03 (b).

More than 40% of the examination applications approved since October 2011 have qualified as "examination eligible only." The Board would still have to conduct a second

education review of the “examination only” candidates at the time they file for licensure. It does not make sense to bifurcate the education review into two parts, one performed by an outside vendor for examination qualification and one performed by the Board for licensure qualification. It is prudent to keep this process housed in one agency.

NASBA’s Education Review Service/Sole Source Vendor Options

A vendor contract to provide education credential review for the CPA Examination applications is not a candidate for sole source procurement. There are many examination and education evaluation services nationwide that are qualified to provide such a service. Thus, NASBA’s education credential review subsidiary, CPA Examination Services (CPAES) would have to competitively bid on a vendor contract to provide these services for the Board. In September 2013 the Board conducted a survey of fees charged by State Boards of Accountancy. The mean cost, nationally, to initially apply for the Uniform CPA Examination is \$131.00. The mean cost to apply as an original examination applicant in a state where NASBA (CPAES) provides education evaluation services is \$146.00. Maryland’s fee for an application to qualify for CPA Examination candidacy is \$60.00.

Another consideration is NASBA’s role as the primary vendor to provide the actual management and the administration of the Uniform CPA Examination. In 2004 when all of the boards of accountancy, nationally, transitioned from paper and pencil administration to computer-based testing, NASBA became the primary vendor of the Uniform CPA Examination. The Board has a contract with NASBA to manage approved Maryland candidates through a National Candidate Database and coordinate examination preparation and grading and testing facilities for its partners, the AICPA and Prometric. AICPA prepares examination questions, maintains a bank of test questions and grades the examination. Prometric provides and maintains the test facilities. NASBA processes examination registrations and scheduling tickets and coordinates score reporting. The Department believes it is prudent to have separate independent processes to (1) determine the qualifications of candidates to sit for the examination; and (2) administer the examination. A separation of vendors for these distinct processes avoids any appearance of a conflict of interest.

In summary, the Board has invested significant resources in the development of a very successful product. Board staff assists applicants in obtaining documentation to support an application, when necessary. It timely processes applications. It resolves most application issues, usually in favor of the applicant locally. It affords applicants with local access to assist them in the application process. The Board’s examination review service provides great value to applicants for the \$60 review fee it charges. The Department does not recommend outsourcing the educational review process at this time.