

**Department of Legislative Services**  
Maryland General Assembly  
2003 Session

**FISCAL AND POLICY NOTE**

Senate Bill 560

(Senators Pinsky and Grosfeld)

Finance

**Corporate Accountability Act of 2003**

This bill establishes the Corporate Accountability Act of 2003. The bill establishes: (1) standards for the corporate accounting and auditing industry; (2) protections for whistle blowers; (3) a whistleblower hotline; and (4) procedures for procurements by units of State government.

**Fiscal Summary**

**State Effect:** General fund expenditures by the Attorney General could increase by \$176,200 in FY 2004, reflecting the cost of enforcement and maintenance of the required hotline. Out-year projections reflect annualization and inflation.

(in dollars)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	176,200	203,400	215,900	229,500	244,200
Net Effect	(\$176,200)	(\$203,400)	(\$215,900)	(\$229,500)	(\$244,200)

*Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect*

**Local Effect:** None.

**Small Business Effect:** Minimal.

**Analysis**

**Bill Summary:** The bill prohibits a registered public accounting firm or person associated with the firm from performing nonauditing services for an issuer of securities while it performs any audit for the issuer required by the federal Securities Exchange Act

of 1934, the rules adopted by the Securities and Exchange Commission (SEC), or the Public Company Accounting Oversight Board. The bill specifies nonaudit services that are always prohibited contemporaneously with an audit. Other nonaudit services may be performed for an audit client only if the activity is approved in advance by the securities issuer's audit committee.

A registered public accounting firm may not provide audit services to a securities issuer if the lead audit partner who has primary responsibility for the audit or the audit partner responsible for reviewing the audit has performed audit services for that issuer in each of the issuer's previous five fiscal years.

The bill prohibits an employer from making, adopting, or enforcing a rule, regulation, or policy that prevents an employee from disclosing information to a government or law enforcement agency if the employee has reasonable cause to believe that the information discloses a violation of State or federal law, or a violation of fiduciary responsibility by a corporation or limited liability company (LLC) to its shareholders, investors, or employees. An employer may not retaliate against an employee for making such a disclosure, refusing to participate in an activity that would result in one of the above mentioned violations, or having exercised these rights with a previous employer. A corporation or LLC that violates these provisions is liable for a civil penalty of up to \$10,000 for each violation. These prohibitions do not apply to the lawyer-client privilege, the physician-patient privilege, or trade secret information.

The bill requires a unit of State government making a procurement to require a bidder or offeror to attach a statement of the compensation of each employee's compensation to the bid or offer. If the bidder or offeror has more than 25 employees, the bidder/offeror may comply by stating the number of employees in each job classification and the highest and lowest salaries in that classification.

The bill also requires the Office of the Attorney General to establish and maintain a whistleblower hotline to receive calls from persons who have information regarding possible violations of the law or of fiduciary responsibilities by a corporation or LLC to its shareholders, investors, or employees. The Attorney General must refer calls received on the hotline to the appropriate government authority for review and possible investigation. Information disclosed as a result of a call to the hotline must be held in confidence during the initial review of the call.

The bill requires a business entity that receives a monetary grant from the State to disclose to the unit or instrumentality offering the grant the compensation of each of the entity's employees. Businesses with more than 25 employees may comply by stating the number of employees in each job classification and the highest and lowest salaries in that

classification. Such salary information is a public record and open to inspection under the State's public records law.

**Current Law:** The State does not currently prohibit accounting firms from performing nonaudit services while performing audits. The State Board of Public Accountancy is responsible for regulating the accounting industry in the State and adopting rules of professional conduct. The board licenses qualified individuals as certified public accountants who meet education requirements, pass an examination, and complete practical work experience. The exam administered by the board is prepared by the American Institute of Certified Public Accountants. The board also issues permits to qualified partnerships, limited liability companies, and corporations to provide certified public accountancy services. The board may hold hearings and take disciplinary action against licensees who violate the law.

The State does not have a generally applicable whistleblower protection law. The State does have whistleblower protection laws that offer protection to executive branch employees of State government and to health care workers. The law applicable to executive branch employees protects those employees from retaliation for: (1) disclosing information that the employee reasonably believes evidences an abuse of authority, gross mismanagement, a gross waste of money, a substantial and specific danger to public health or safety, or a violation of law; or (2) seeking a legal remedy following a disclosure. The health care worker whistleblower protection law prohibits reprisal against a health care worker who (1) discloses or threatens to disclose an activity, policy, or practice of the employer that is in violation of a law, rule, or regulation; (2) provides information to or testifies before any public body conducting an investigation, hearing, or inquiry into any violation of a law, rule, or regulation by the employer; or (3) objects to or refuses to participate in any activity, policy, or practice in violation of a law, rule, or regulation.

Under the State's procurement laws, a unit of State government must draft specifications to encourage maximum practical competition without modifying the State's requirements. Neither bidders or offerors under State contracts nor business entities that receive monetary grants from the State are required to disclose the salaries of their employees.

**Background:** The federal Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley) was enacted in response to the recent spate of accounting scandals and fraud allegations involving major American corporations and accounting firms. Generally, Sarbanes-Oxley affects publicly-traded companies that report to the SEC.

Sarbanes-Oxley places several restrictions on accounting firms. The Act prohibits a public accounting firm from providing auditing services to a public company if the lead audit partner or audit partner reviewing the audit has performed audit services for the company in each of the company's five previous fiscal years. A registered public accounting firm may not perform any audit service for a public company if a chief executive officer (CEO), controller, chief financial officer (CFO), or chief accounting officer of the company (1) was employed by the accounting firm; and (2) participated in the audit during the one-year period preceding the date on which the audit was initiated. The Act also prohibits accounting firms from selling consulting (nonaudit) services to their audit clients without pre-approval of the board.

The Act establishes the Public Company Accounting Oversight Board to oversee the audit of public companies that are subject to the securities laws and to discipline auditors. The five-member board (a private, nonprofit corporate entity) must (1) adopt auditing standards; (2) adopt independence standards; (3) inspect auditing firms; (4) conduct disciplinary proceedings against public accounting firms that prepare audit reports for issuers and their personnel, who could face revocation of their license and fines up to \$15 million; (5) require public accounting firms to register with the board; and (6) be funded by fees on public companies based on their market capitalizations. The board is required to cooperate with professional groups of accountants to determine the need for changes in standards.

Sarbanes-Oxley makes various disclosure requirements to increase investor confidence. Corporate CEOs and CFOs must certify their companies' financial statements filed with the SEC. While there is no penalty for failing to file a certification, failure to file may lower investor confidence in public companies that do not file.

Other changes affecting public companies include enhanced criminal penalties for a broad array of white collar crimes and a prohibition of corporate loans to company executives. Sarbanes-Oxley also directs the SEC to require that securities firms create a firewall between research and investment banking personnel. Under the Act, retaliating against a corporate whistle blower is also a crime. The oversight board is required to complete studies and report on various aspects of the Act.

**State Expenditures:** The bill will impose new duties on the Attorney General in connection with creating the hotline and new regulatory and enforcement duties on the Securities Division. General fund expenditures could increase by an estimated \$176,200 in fiscal 2004, which accounts for the bill's October 1, 2003 effective date. This estimate reflects the cost of hiring one assistant attorney general, one fraud investigator, two paralegals, and two administrative support staff to investigate and prosecute prohibited acts under the bill and to maintain the whistleblower hotline established under the bill. It

includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Salaries and Fringe Benefits	\$145,800
Other Operating Expenses	<u>30,400</u>
<b>Total FY 2004 State Expenditures</b>	<b>\$176,200</b>

Future year expenditures reflect: (1) full salaries with 4.5% annual increases and 3% employee; and (2) 1% annual increases in ongoing operating expenses.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** Department of Assessments and Taxation; Department of Labor, Licensing, and Regulation; Office of the Attorney General, Department of Legislative Services

**Fiscal Note History:** First Reader - February 14, 2003  
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