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REVIEW COMMISSION

IRRC Number: 2101

(1) Agency

Department of State, Bureau of Professional and Occupational Affairs, State Board of Accountancy

(2) I.D. Number (Governor's Office Use)

16A-557

(3) Short Title

Commissions and Referral Fees

(4) PA Code Cite

49 Pa. Code §11.24

(5) Agency Contacts & Telephone Numbers

Primary Contact: **Steven Wennberg, Board Counsel 783-7200**

Secondary Contact: **Joyce McKeever, Deputy Chief Counsel, 783-7200**

(6) Type of Rulemaking (check one)

Proposed Rulemaking
X Final Order Adopting Regulation
Final Order, Proposed Rulemaking Omitted

(7) Is a 120-Day Emergency Certification Attached?

X No
Yes: By the Attorney General
Yes: By the Governor

(8) Briefly explain the regulation in clear and nontechnical language.

The regulations require licensed public accounting firms, licensed certified public accountants and licensed public accountants to notify the Board when they receive or intend to receive commissions; to permit peer reviewers access to compensation records for the purpose of verifying that commissions were not received for referring products or services to attest clients; to acquire and maintain in good standing any licenses or registrations (Continued on Page 9)

(9) State the statutory authority for the regulation and any relevant state or federal court decisions.

Sections 3(a)(11) and 3(a)(12) of the CPA Law, 63 P.S. §§9.3(a)(11) and 9.3(a)(12), empower the Board to promulgate, respectively, regulations related to professional conduct and administrative regulations necessary to carry out the purposes of the CPA Law. Section 12(p)(4) of the CPA Law, 63 P.S. §9.12(p)(4), empowers the Board to promulgate the manner in which licensees must disclose commissions and referral fees.

Regulatory Analysis

(10) Is the regulation mandated by any federal or state law or court order, or federal regulation? If yes, cite the specific law, case or regulation, and any deadlines for action.

The part of the regulations that addresses the manner in which licensees disclose commissions and referral fees is mandated by Section 12(p)(4) of the CPA Law. The remaining parts of the regulation are not mandated by federal or state law, court order or regulation.

(11) Explain the compelling public interest that justifies the regulation. What is the problem it addresses?

The regulations ensure that licensees who receive commissions and referral fees (1) are monitored for adherence to statutory prohibitions, (2) possess appropriate qualifications, (3) make adequate disclosures to clients, and (4) maintain workpapers that reflect their exercise of professional judgment.

(12) State the public health, safety, environmental or general welfare risks associated with nonregulation.

The principal risk associated with nonregulation is that the financial interests of persons who engage the professional services of licensees could be jeopardized by the absence of adequate disclosure and other ethical safeguards relating to the licensees' receipt of commissions and referral fees.

(13) Describe who will benefit from the regulation. (Quantify the benefits as completely as possible and approximate the number of people who will benefit.)

The regulations would benefit the public at large because requiring licensees to observe meaningful ethical standards in connection with their receipt of commissions and referral fees (1) reduces the likelihood that clients will be harmed by overreaching licensees and (2) contributes to the public's confidence in the integrity of the public accounting profession.

(14) Describe who will be adversely affected by the regulation. (Quantify the adverse effects as completely as possible and approximate the number of people who will be adversely affected.)

The Board cannot identify any groups that will be adversely affected by the regulations.

(15) List the persons, groups or entities that will be required to comply with the regulation. (Approximate the number of people who will be required to comply.)

All licensees engaged in public practice who receive commissions or who accept or pay referral fees will be required to comply with the regulations. As of January 12, 2000, there were 19,883 currently licensed certified public accountants; 432 currently licensed public accountants; and 1,043 currently licensed public accounting firms. It is not known how many licensees receive commissions or accept or pay referral fees.

(16) Describe the communications with and input from the public in the development and drafting of the regulation. List the persons and/or groups who were involved, if applicable.

In developing the regulations for proposed rukemaking, the Board solicited and received comments from the Pennsylvania Institute of Certified Public Accountants and the Pennsylvania Society of the Public Accountants. The Board also received comments from a financial services firm and a public accounting firm.

(17) Provide a specific estimate of the costs and/or savings to the regulated community associated with compliance, including any legal, accounting or consulting procedures which may be required.

The Board cannot quantify the costs associated with compliance with the regulations (e.g., acquisition of other relevant licenses and registrations, documentation of disclosures, retention of workpapers). However, the costs would appear to be minimal and would not likely deter any licensee from entering into commission/referral fee arrangements.

(18) Provide a specific estimate of the costs and/or savings to local governments associated with compliance, including any legal, accounting or consulting procedures which may be required.

The regulations may cause local political subdivisions that retain licensees for auditing and investment services to contract with separate licensees for those services. It is unclear whether such arrangements would result in costs or savings for the political subdivisions.

(19) Provide a specific estimate of the costs and/or savings to state government associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required.

The regulations will cause the Board to incur costs in revising its biennial renewal form to include a question about whether the licensee receives commissions. The regulations also will cause the Board to incur costs in entering this information into its computer records. Although these costs cannot be quantified, they are negligible.

Regulatory Analysis Form

(20) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years.

	Current FY Year	FY +1 Year	FY +2 Year	FY +3 Year	FY +4 Year	FY +5 Year
SAVINGS:	$N/A	$N/A	$N/A	$N/A	$N/A	$N/A
Regulated						
Local Government						
State Government						
Total Savings						
COSTS:	$N/A					
Regulated		See 17	See 17	See 17	See 17	See 17
Local Government		See 18	See 18	See 18	See 18	See 18
State Government		See 19	See 19	See 19	See 19	See 19
Total Costs						
REVENUE LOSSES:	$N/A	$N/A	$N/A	$N/A	$N/A	$N/A
Regulated						
Local Government						
State Government						
Total Revenue Losses						

(20a) Explain how the cost estimates listed above were derived.

As set forth in Items 17, 18 and 19, the estimated costs of the regulation for the regulated community, local government and state government cannot be quantified.

(20b) Provide the past three year expenditure history for programs affected by the regulation.

Program	FY -3	FY -2	FY -1	Current FY
Accountancy	$579,731.92	$636,828.58	$714,838.10 (est.)	$684,000 (est.)

(21) Using the cost-benefit information provided above, explain how the benefits of the regulation outweigh the adverse effects and costs.

The regulations will benefit the public by ensuring that licensees who receive commissions or accept or pay referral fees are subject to appropriate ethical safeguards. The need for this benefit outweighs its cost to the regulated community, local government and state government.

(22) Describe the nonregulatory alternatives considered and the costs associated with those alternatives. Provide the reasons for their dismissal.

A nonregulatory alternative was not available to the Board. The CPA Law mandates that disclosure requirements and other standards of professional conduct be codified by regulation.

(23) Describe alternative regulatory schemes considered and the costs associated with those schemes. Provide the reasons for their dismissal.

Because the regulations only amend an existing regulatory scheme, the Board did not consider an alternative regulatory scheme. However, the proposed version of the regulations contained a provision that would have prohibited licensees from receiving commissions from individuals or entities that could exercise significant influence over the operating, financial or accounting policies of clients for whom the licensees perform auditing or other attest services. The Board deleted the provision because of concerns about whether it exceeded the Board's rulemaking authority under the CPA Law.

(24) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulation.

There are no federal standards applicable to commissions and referral fees received by licensed accountants.

(25) How does this regulation compare with those of other states? Will the regulation put Pennsylvania at a competitive disadvantage with other states?

Of the 36 states that responded to the Board's survey, 23 states (including New Jersey, Ohio and Maryland) permit licensed accountants to receive commissions, while 13 states (including New York) do not. Most states that permit licensed accountants to receive commissions have requirements and restrictions similar to those set forth in Section 12(p) of the CPA Law.

The Board has no reason to believe that the regulations will put Pennsylvania at a competitive disadvantage with other states.

(26) Will the regulation affect existing or proposed regulations of the promulgating agency or other state agencies? If yes, explain and provide specific citations.

The regulations will not affect other existing or proposed regulations of the Board or of any other state agency.

(27) Will any public hearings or informational meetings be scheduled? Please provide the dates, times, and locations, if available.

The Board has not scheduled public hearings or informational meetings in connection with final rulemaking. The Board will likely apprise licensees of the regulations in its annual newsletter and on its website.

(28) Will the regulation change existing reporting, record keeping, or other paperwork requirements? Describe the changes and attach copies of forms or reports which will be required as a result of implementation, if available.

The regulations will require licensees to notify the Board if they receive or intend to receive commissions; to make their compensation records available to peer reviewers for the purpose of verifying that no commissions were received in connection with attest clients; to make written disclosures of commissions and referral fees in their engagement and representation letters; and to keep workpapers that document their reasons for referring particular commission-based products and services to clients.

(29) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.

The regulations will apply uniformly to all licensees that receive commissions or referral fees. The Board perceives no reason why any class or subclass of licensees should be exempt from the regulations.

(30) What is the anticipated effective date of the regulation; the date by which compliance with the regulation will be required; and the date by which any required permits, licenses or other approvals must be obtained?

The regulations will take effect upon final publication in the Pennsylvania Bulletin.

(31) Provide the schedule for continual review of the regulation.

The Board intends to conduct an annual review of the regulations to evaluate their continued effectiveness.

(Continued from Page 1)

required by other governmental or private standard-setting bodies relating to the receipt of commissions; to disclose commissions in client engagement and representation letters; and to maintain workpapers that document the basis for recommending particular products and services to clients. The regulations also require licensees who accept or pay referral fees to disclose the fees in client engagement and representation letters.

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FACE SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU

(Pursuant to Commonwealth Documents Law)

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REVIEW COMMISSION

\# 2101

DO NOT WRITE IN THIS SPACE

Copy below is hereby approved as to form and legality. Attorney General BY: ______________ (DEPUTY ATTORNEY GENERAL) ______________ DATE OF APPROVAL [ ] Check if applicable Copy not approved. Objections attached.	Copy below is hereby certified to be a true and correct copy of a document issued, prescribed or promulgated by: State Board of Accountancy (AGENCY) DOCUMENT/FISCAL NOTE NO. 16A-557 DATE OF ADOPTION: ______________ BY: Thomas J. Baumgartner, CPA TITLE: Chairman (EXECUTIVE OFFICER, CHAIRMAN OR SECRETARY)	Copy below is approved as to form and legality. Executive or Independent Agencies. BY: ______________ 10/6/00 DATE OF APPROVAL (Deputy General Counsel ~~(Chief Counsel,~~ ~~Independent Agency~~ (Strike inapplicable title) [ ] Check if applicable. No Attorney General approval or objection within 30 day after submission.

ORDER OF FINAL RULEMAKING

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF STATE
BUREAU OF PROFESSIONAL AND OCCUPATIONAL AFFAIRS
STATE BOARD OF ACCOUNTANCY
(49 PA. CODE, CHAPTER 11)

COMMISSIONS AND REFERRAL FEES

PREAMBLE

The State Board of Accountancy (Board), by this order, amends Chapter 11 by revising §11.24 to read as set forth in Annex A.

The amendments revise §11.24 (relating to commissions) to permit licensed public accounting firms and licensed certified public accountants and public accountants engaged in public practice to receive or accept commissions and to accept or pay referral fees in accordance with Section 12(p) of the CPA Law, 63 P.S. §9.12(p), which was added by the Act of December 4, 1996, P.L. 851 (Act 140 of 1996). The existing §11.24, enacted in 1970, prohibits commissions and referral fees absolutely. The amendments require licensees to notify the Board when they receive or intend to receive commissions; to allow peer reviewers access to compensation records for purposes of verifying that commissions were not received for referring products or services to attest clients; to acquire and maintain in good standing any licenses or registrations required by other governmental or private standard-setting bodies relating to the receipt of commissions; to disclose commissions in client engagement letters and representation letters; and to maintain workpapers that document the basis for recommending particular products or services to clients. The amendments also require licensees who accept or pay referral fees to disclose the fees in client engagement and representation letters.

Summary of Comments and Responses to Proposed Rulemaking

The Board published a notice of proposed rulemaking on March 4, 2000 (30 Pa. B.1271), following which the Board entertained public comments for a period of 30 days. The Board received comments from the Pennsylvania Institute of Certified Public Accountants (PICPA), the Pennsylvania Society of Public Accountants (PSPA), the two major professional organizations that represent the public accounting profession in Pennsylvania; H. D. Vest, a leading financial services company; and 158 individual licensees.

The Board received comments from the House Professional Licensure Committee (House Committee) on April 11, 2000, and the Independent Regulatory Review Commission (IRRC) on May 4, 2000, as part of their review of the proposed amendments under the Regulatory Review Act. The Board did not receive comments from the Senate Consumer Protection and Professional Licensure Committee (Senate Committee), which also reviewed the proposed amendments under the Regulatory Review Act.

Following is a summary of the comments that the Board received during proposed rulemaking and of the changes the Board has made to the proposed amendments in response to the comments:

The House Committee asked the Board to explain why it took more than three years to publish proposed regulations that are intended to implement the provisions of Section 12(p) of the CPA Law. In developing an exposure draft of the regulations for preproposal comments under Executive Order 1996-1 (relating to regulatory review and promulgation), the Board considered several policy options. In June 1998, the Board finalized its exposure draft, and in August 1998 submitted the exposure draft to the major professional organizations for preproposal comments. The Board received preproposal comments through January 1999. In June 1999, the Board conducted a poll of other jurisdictions regarding their restrictions on commissions and referral fees before settling upon a final version of its proposal. In November 1999, the Board submitted its proposal for prepublication regulatory review, which concluded with publication of the notice of proposed rulemaking in March 2000.

§11.24(b) (Notification to the Board)

Section 11.24(b) requires licensees who receive or intend to receive commissions to report that fact on their applications for biennial renewal of licensure. In its notice of proposed rulemaking, the Board stated that the notification requirement will assist it in determining which licensees require monitoring to ensure compliance with Section 12(p) of the CPA Law and §11.24.

The IRRC asked the Board to explain the need for monitoring and how the monitoring will be implemented. The Board believes monitoring is complementary of the complaints process, which is the Board's usual source of information about licensees who may not be in compliance with the CPA Law and the Board's regulations. Consumers who are referred by licensees to commission-based products or services may be unaware of the requirements relating to commissions, and thus may not report noncomplying licensees to the Board. The greatest risk to consumers in the area of commissions stems from licensees who violate the prohibition, set forth in Section 12(p)(1) of the CPA Law, against referring or recommending clients to commission-based products or services when the licensees or their firms also perform audit, review or certain other attest services for the clients. To monitor compliance with this prohibition, the Board would furnish peer review administering organizations with a list of licensees who report receiving commissions. The CPA Law mandates periodic peer review of licensees who perform audit or review engagements. The peer reviewers would scrutinize the compensation records of those licensees who report receiving commissions to determine whether commission-based products or services were referred or recommended to attest clients.

The IRRC also asked the Board to explain what is meant by the phrase "intends to receive commissions." Licensees will be asked to indicate on their license renewal applications whether they have received commissions during the preceding license renewal period and whether they intend to recommend or refer commission-based products or services to clients during the upcoming license renewal period.

§11.24(c) (Cooperation with peer reviewers)

Proposed §11.24(c) required licensees who receive commissions and who are subject to peer review to furnish peer reviewers with the necessary documentation to establish the licensees' compliance with Section 12(p) of the CPA Law and §11.24.

The IRRC recommended that the Board define what is meant by "necessary documentation." As stated above, in order to determine whether licensees may have received unlawful commissions under Section 12(p)(1) of the CPA Law, the peer reviewers must review the compensation records of licensees who perform attest engagements. The Board has revised §11.24(c) to specify that compensation records comprise the required documentation. (Because their scope of authority is limited to evaluating licensees' quality control procedures and policies for attest engagements, peer reviewers are unable to serve as the Board's agents in monitoring licensees' compliance with disclosure and other requirements unrelated to the attest function.)

In its notice of proposed rulemaking, the Board stated that licensees who sell commission-based products or services to attest clients would not receive unqualified peer reviews. The PSPA observed that under Section 12(p)(1) of the CPA Law, licensees are permitted to sell commission-based products or services to attest clients where the attest services involve compilations of financial statements in which the licensees have disclosed their lack of independence. The Board agrees with the PSPA's clarification that the licensees' receipt of commissions in such circumstances would not make them ineligible for unqualified peer reviews.

§11.24(d) (Related licensure / registration)

Proposed §11.24(d) required licensees, prior to receiving commissions, to acquire and maintain in good standing any licenses or registrations required by other governmental or regulatory bodies for the purpose of receiving commissions. The Board stated by way of example in its notice of proposed rulemaking that licensees who desire to receive commissions for the sale of securities may need to be registered with such entities as the Pennsylvania Securities Commission (PSC),a state agency that regulates certain nonfederally covered broker/dealers, agents, and investment advisors and representatives who conduct business in Pennsylvania, or the National Association of

Securities Dealers (NASD), a self-regulatory organization that credentials broker/dealers and registered representatives who sell securities on the Nasdaq Stock Market and the over-the-counter securities market.

The IRRC asked the Board to explain the purpose of the related licensure/registration requirement and to provide examples of such required licensure or registration in §11.24(d). The IRRC also commented that the NASD is not a governmental or regulatory body but a private standard-setting body, and recommended that the wording of §11.24(d) be revised to include private standard-setting bodies.

The purpose of the related licensure/registration requirement is to ensure that licensees have acquired a sufficient level of training, understanding and experience regarding commission-based products or services so that they can make knowledgeable and informed recommendations and referrals of those products or services to clients. Such minimum competence is established through the licensure/registration requirements of governmental or private standard-setting bodies that regulate or mediate commerce in those products or services. The most common examples of commission-based products and services for which licensure or registration may be required are the sale of securities (e.g., PSC, NASD), the sale of insurance (State Department of Insurance), and the sale of real estate (State Real Estate Commission).

Consistent with the IRRC's recommendations, the Board has revised §11.24(d) to clarify that licensees must obtain appropriate licensure or registration from other governmental or private standard-setting bodies that may be required in order to receive commissions. The Board also has added to §11.24(d) the above-cited examples of such governmental or private standard-setting bodies.

§11.24(f) (Workpapers)

Section 11.24(f) requires licensees who receive commissions to maintain workpapers that document discussions regarding their clients' investment needs, the investment strategies considered, and the bases for the investment strategies recommended. The purpose of this requirement is to ensure that licensees have exercised professional judgment in the course of recommending or referring commission-based products or services to clients.

H. D. Vest questioned the Board's legal authority to establish a workpaper requirement, commenting that Section 12(p)(4) of the CPA Law only references the Board's authority to promulgate regulations on matters relating to a licensee's disclosure of commissions and referral fees to a client. While Section 12(p)(4) of the CPA Law clearly directs the Board to promulgate regulations relating to disclosure requirements, the Board does not interpret such language as limiting the Board's rulemaking authority on commissions and referral fees to matters of disclosure only. Section 3(a)(11) of the CPA Law, 63 P.S. §9.3(a)(11), authorizes the Board to promulgate rules of professional conduct for licensees, while Section 3(a)(12) of the CPA Law, 63 P.S. §9.3(a)(12), authorizes the Board to promulgate such other regulations, consistent with the CPA Law, that are necessary and proper to implement the provisions of the CPA Law. Recommending or referring commission-based products or services to clients plainly implicates standards of professional conduct; if such were not the case, there would be no reason for the CPA Law's prohibition against licensees' recommending or referring commission-based products or services to certain attest clients. Section 11.24(f) represents a lawful exercise of the Board's authority to establish a standard of professional conduct.

Both H. D. Vest and the PSPA observed that for commissions related to securities, §11.24(f) may duplicate the paperwork requirements of federal and state securities regulations. The Board does not intend to require licensees to maintain redundant workpapers; workpapers maintained by licensees pursuant to securities regulations would be considered adequate so long as they reflected discussions of clients' investment needs, the investment strategies considered, and the bases for the investment strategies recommended.

The IRRC recommended that because failure to maintain workpapers could expose licensees to disciplinary action, and because there are expenses associated with the retention and storage of such workpapers, §11.24(f) should be amended to state how long licensees must retain workpapers. The Board does not believe a specific retention period is necessary for licensees' commission-related workpapers. Section 11 of the CPA Law, 63 P.S. §9.11, requires licensees to produce client records upon request but does not establish a specific retention period. Moreover, the workpapers required under §11.24(f) are not likely to be voluminous; therefore, the costs associated with their retention and storage are likely to be minimal. Significantly, not one of the 158 individual licensees who commented on the proposed rulemaking raised any objection to the costs of retaining workpapers under §11.24(f).

§11.24(g) (Attest client)

Proposed §11.24(g) would have provided that for purposes of Section 12(p)(1) of the CPA Law, licensees who perform attest services for clients – except for compilations of financial statements likely to be relied upon by third parties and accompanied by disclosures of lack of independence, as permitted under Section 12(p)(ii) of the CPA Law – may not receive commissions for recommending or referring products or services to individuals or entities that can exercise significant influence over the operating, financial or accounting policies of the licensees' attest clients.

Proposed §11.24(g) would have defined "significant influence" to include situations in which the individual or entity (1) is connected with the client as a promoter, underwriter, voting trustee, general partner or nonhonorary director; (2) is connected with the client in a policymaking position related to the client's primary operating, financial or accounting policies, such as chief executive officer, chief financial officer, or chief accounting officer; or (3) meets the criteria established in Accounting Principles Board Opinion 18, "The Equity Method of Accounting for Investments in Common Stock," and its interpretations, to determine the ability of an investor to exercise the influence with respect to the client. The proposed significant influence standard was derived verbatim from the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct's Ethical Interpretation relating to the effect that a certified public accountant's financial interest in a nonclient has on his independence with a client when the nonclient has an investor or investee relationship with the client (ET §101.10).

Proposed §11.24(g) was intended to address a situation, not expressly covered by Section 12(p)(1) of the CPA Law, in which licensees receive commissions for products or services sold to individuals or entities that, while not the attest clients of the licensees, could nevertheless substantially impact the business affairs of other clients for whom the licensees perform attest services. The Board strongly believes that licensees' receipt of commissions in such circumstances may impair their independence as auditors. The licensees' financial interests in receiving commissions could result, intentionally or unintentionally, in the weakening of their objectivity in evaluating the financial enterprises of attest clients who are subject to the significant influence of the licensees'commission clients; in some cases, licensees could be in the position of auditing the value or financial consequences of products or services for which they received commissions.

All commentators questioned the Board's legal authority to promulgate proposed §11.24(g). Most significantly, the House Committee, noting that the prohibition in Section 12(p)(1)of the CPA Law specifically relates to recommendations and referrals made to clients for whom licensees perform certain types of attest services, opined that the Board had "no apparent statutory authority" to expand the scope of Section12(p)(1) to cover other parties, regardless of whether those parties are in a position to exercise significant influence over clients for whom licensees perform attest services. The IRRC, in turn, stated that the House Committee's comments "clearly indicate that the legislative intent was to limit [Section 12(p)(1)] to transactions involving attest clients." The IRRC recommended that the Board seek clarification from the General Assembly before attempting to establish a rule of professional conduct that extends beyond what is currently contemplated by the CPA Law.

In deference to the House Committee's and the IRRC's view that proposed §11.24(g) exceeded the Board's rulemaking authority, the Board has deleted it from the final-form amendments. However, the Board remains steadfast in its belief that the current prohibition in Section 12(p)(1) is inadequate to protect the public against the adverse impact that commissions may have on licensees' ability to perform attest services with the requisite independence. The Board intends to ask the General Assembly to amend the CPA Law to specifically prohibit a licensee's receipt of commissions in circumstances like those set forth in proposed §11.24(g) or, alternatively, to give the Board express authority to establish such a prohibition by regulation.

Apart from their objection to the Board's legal authority to promulgate proposed §11.24(g), the commentators raised other concerns about proposed §11.24(g) that should be addressed in view of the Board's desire to seek its implementation through legislation.

Except for the House Committee, all commentators expressed concerns that the significant influence standard was either vague, ambiguous or confusing. The PICPA, echoing the concerns of the PSPA, H. D. Vest and the individual commentators, said that by linking together two separate engagements (attestation and investment services) and two separate clients (attest client and shareholder, employee, etc. of attest client), the Board had created a difficult interpretative issue because the ethical rules governing licensee independence are written to include only attest activities and thus provide no measurement standard for determining how independence may be impaired by the receipt of commissions. The PICPA had made these same comments in response to a preproposal draft of §11.24 that would have simply provided that a licensee may not receive a commission from any individual or entity that could impair the licensee's independence, either by appearance or in fact, with respect to an attest client of the license; the PICPA's recommendation to the Board at the time was to either delete the provision or replace it with the AICPA Code of Professional Conduct's significant influence standard, which would provide licensees with definitive criteria for assessing when the receipt of commissions could impair independence. Proposed §11.24(g) incorporated the significant influence standard initially recommended by the PICPA.

The IRRC commented that the ambiguity in proposed §11.24(g) was the use of the word "includes" to introduce the three situations that define how an entity or individual may exercise "significant influence"on the business affairs of an attest client. The IRRC observed that "includes" suggests that there are situations other than those listed in the regulation that may define significant influence. The IRRC recommended that if the significant influence standard were retained in the final-form amendments, the term should be defined to set forth a complete list of applicable situations. The Board notes that under the AICPA Code of Professional Conduct, the three situations descriptive of significant influence are not considered all-inclusive. The Board will propose that the amendatory language to the CPA Law set forth as comprehensive a definition of significant influence as is possible under current ethical standards.

The IRRC also recommended that the reference in proposed §11.24(g) to Section 12(p)(ii) of the CPA Law either be deleted as unnecessary or, if retained, be revised to mirror the exact statutory language. The IRRC noted that the Board's shorthand reference to Section 12(p)(ii) had the unintentional effect of expanding the exception to the prohibition of receipt of commissions from attest clients to include situations involving compilations of financial statements with no disclosure of lack of independence; the statutory exception only applies to compilations where lack of independence is disclosed. The Board agrees with the IRRC's recommendation, and will propose that the amendatory language to the CPA Law be consistent with the existing exception in Section 12(p)(ii).

The IRRC, the PICPA, and the individual commentators also raised concerns that proposed §11.24(g) would have an adverse fiscal impact on licensees by limiting their ability to offer a full range of services to clients. Clients with financial planning or investment needs may take their business to other financial service professionals in Pennsylvania or to licensees in Pennsylvania's border states with less restrictive commission requirements.

As the Board stated in its notice of proposed rulemaking, the adoption of a significant influence standard would certainly result in loss of unspecified commission opportunities for certain licensees. While some of those lost commission opportunities could end up benefitting out-of-state licensees as well as the financial services industry at large, other commission opportunities would simply be transferred to those in-state licensees whose independence would not be impaired by the receipt of commissions. The Board considers it noteworthy that none of the commentators from the public accounting profession have suggested that lost commission opportunities would likely cause financial hardship to licensees, such as the laying off of personnel or the closing of offices. In the absence of a showing of financial hardship to licensees, the Board believes that the salutary impact of the significant influence standard on licensee independence – a factor that redounds to the benefit of attest clients and to those who rely on the attestation services of licensees – outweighs the loss of potential earnings to licensees in the form of commissions.

Statutory Authority

Sections 3(a)(11) and 3(a)(12) of the CPA Law, 63 P.S. §§9.3(a)(11) and 9.3(a)(12), empower the Board to promulgate, respectively, regulations relating to professional conduct and administrative regulations necessary to carry out the provisions of the CPA Law. Section 12(p)(4) of the CPA Law empowers the Board to promulgate regulations specifying minimum disclosure requirements when receiving commissions or accepting or paying referral fees.

Fiscal Impact and Paperwork Requirements

The amendments will not have a fiscal impact on the Commonwealth's agencies or its political subdivisions.

The amendments will require licensees to maintain records of their disclosures of commissions and referral fees as well as workpapers documenting the appropriateness of recommending or referring particular commission-based products or services to clients. The amendments will require the Board to revise its biennial license renewal form to include a question about whether licensees have received or intend to receive commissions; the Board will use this information for the purpose of monitoring compliance with Section 12(p)(1) of the Law. The amendments will not create new paperwork requirements for the Commonwealth's other agencies, the Commonwealth's political subdivisions, or other segments of the private sector.

Compliance with Executive Order 1996-1

In accordance with Executive Order 1996-1 (relating to regulatory review and promulgation), the Board, in developing the preproposal version of the amendments, solicited comments from the PICPA and the PSPA on behalf of their memberships.

Regulatory Review

On February 23, 2000, as required by Section 5(a) of the Regulatory Review Act, 71 P.S. §745.5(a), the Board submitted copies of a notice of proposed rulemaking, published at 30 Pa .B. 1271 (March 4, 2000), to the IRRC and the House and Senate Committees for review and comment.

In adopting final-form amendments, the Board considered comments from the IRRC, the House Committee, and the general public. The Board did not receive comments from the Senate Committee.

On October 30, 2000, the Board submitted final-form amendments to the IRRC and the House and Senate Committees. Under authority of Section 5(c) of the Regulatory Review Act, 71

P.S. §745.5(c), the amendments were approved by the House Committee on ______________, 2000, approved by the Senate Committee on ______________, 2000, and approved by the IRRC on ______________, 2000.

Additional Information

Individuals who desire additional information about the amendments are invited to submit inquiries to Steven Wennberg, Esq., Counsel, State Board of Accountancy, P. O. Box 2649, Harrisburg, PA 17105-2649.

Findings

The Board finds that:

(1) Public notice of the Board's intention to amend 49 Pa. Code, Chapter 11, by this order, has been given under Sections 201 and 202 of the Commonwealth's Documents Law, 45 P.S. §§1201 and 1202, and the regulations thereunder, 1 Pa. Code §§7.1 and 7.2.

(2) The amendments adopted by this order are necessary and appropriate for the administration of the CPA Law.

Order

The Board, acting under its authorizing statute, orders that:

(a) The regulations of the Board, 49 Pa. Code, Chapter 11, are amended by revising §11.24 to read as set forth in Annex A.

(b) The Board shall submit this order and Annex A to the Office of Attorney General and the Office of General Counsel for approval as required by law.

(c) The Board shall certify this order and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(d) The amendments shall take effect upon publication in the Pennsylvania Bulletin.

ANNEX A

TITLE 49. PROFESSIONAL AND VOCATIONAL STANDARDS
PART I. DEPARTMENT OF STATE
Subpart A. PROFESSIONAL AND OCCUPATIONAL AFFAIRS
CHAPTER 11. STATE BOARD OF ACCOUNTANCY

GENERAL PROVISIONS

* * *

§11.24. Commissions and referral fees.

(a) *General*. [A licensee may not pay a commission to obtain a client nor accept a commission for a referral to a client of products or services of others. This section does not prohibit payments for the purchase of all or a material part of an accounting practice, or retirement payments to persons formerly engaged in the practice of public accounting or payments to the heirs or restates of those persons.] A licensee engaged in public practice is permitted to receive commissions and accept or pay referral fees subject to the requirements set forth in section 12(p) of the act (63 P.S. §9.12(p)) and this section.

(b) *Notification to Board*. A licensee who receives or intends to receive commissions shall report this fact on the application for biennial renewal of the license.

(c) *Cooperation with peer reviewer*. A licensee who receives commissions and who is subject to peer review under section 8.9 of the act (63 P.S. §9.8i) shall furnish peer reviewers with ~~the necessary documentation~~ COMPENSATION RECORDS ~~to establish~~ FOR PURPOSES OF VERIFYING compliance with section 12(p)(1) of the act ~~and this section~~.

(d) *Related licensure/registration*. Prior to receiving commissions, a licensee shall acquire and maintain in good standing any license or registration required by another governmental or ~~regulatory~~ PRIVATE STANDARD-SETTING body for the purpose of receiving commissions. EXAMPLES OF BODIES THAT MAY REGULATE THE RECEIPT OF COMMISSIONS ARE PENNSYLVANIA SECURITIES COMMISSION (SALE OF SECURITIES), NATIONAL ASSOCIATION OF SECURITIES DEALERS (SALE OF SECURITIES), STATE DEPARTMENT OF INSURANCE (SALE OF INSURANCE), AND STATE REAL ESTATE COMMISSION (SALE OF REAL ESTATE).

(e) *Disclosure to client.* A licensee who receives a commission or who accepts or pays a referral fee shall make the disclosures required by section 12(p)(4) of the act in an engagement or representation letter that is signed by the client.

(f) *Workpapers.* A licensee who receives a commission shall maintain workpapers that document discussions regarding the client's investment needs, the investment strategies considered, and the basis for the investment strategy recommended by the licensee.

~~(g) *Attest clients.* For purposes of section 12(p)(1) of the act, a licensee who performs an attest activity for a client, except as set forth in section 12(p)(1)(ii) of the act, may not receive a commission for recommending or referring a product or service to an individual or entity that can exercise significant influence over the operating, financial or accounting policies of the client. For purposes of this subsection, "significant influence" includes any of the following situations:~~

~~(i) The individual or entity is connected with the client as a promoter, underwriter, voting trustee, general partner or director (other than an honorary director as defined in the AICPA Code of Professional Conduct).~~

~~(ii) The individual or entity is connected with the client in a policymaking position related to the client's primary operating, financial, or accounting policies, such as chief executive officer, chief operating officer, chief financial officer, or chief accounting officer.~~

~~(iii) The individual or entity meets the criteria established in Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, and its interpretations, to determine the ability of an investor to exercise such influence with respect to the client.~~

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF STATE
BUREAU OF PROFESSIONAL AND OCCUPATIONAL AFFAIRS
STATE BOARD OF ACCOUNTANCY

(717) 783-1404

116 PINE STREET
P. O. BOX 2649
HARRISBURG, PA
17105-2649

October 30, 2000

The Honorable John R. McGinley, Jr., Esq.
Chairman
Independent Regulatory Review Commission
Harristown 2, 14th Floor
333 Market Street
Harrisburg, PA 17101

RE: Final Rulemaking of the State Board of Accountancy
Relating to Commissions and Referral Fees (16A-557)

Dear Chairman McGinley:

Enclosed is a copy of a final rulemaking package of the State Board of Accountancy relating to commissions and referral fees.

The final-form regulation incorporates several changes to address concerns raised by the public commentators, your Commission, and the House Professional Licensure Committee during proposed rulemaking.

The Board stands ready to provide whatever information or assistance your Commission may require during its review of this final rulemaking.

Sincerely,

Thomas J. Baumgartner CPA

Thomas J. Baumgartner, Chairman
State Board of Accountancy

TJB:SW:apm
Enclosure

cc: John T. Henderson, Jr., Chief Counsel
Department of State

Joyce McKeever, Deputy Chief Counsel
Department of State

Lee Ann H. Murray, Regulatory Counsel
Department of State

David Williams, Deputy Commissioner
Bureau of Professional and Occupational Affairs

Gerald S. Smith, Senior Counsel in Charge
Bureau of Professional and Occupational Affairs

Steven Wennberg, Counsel
State Board of Accountancy

State Board of Accountancy

TRANSMITTAL SHEET FOR REGULATIONS SUBJECT TO THE REGULATORY REVIEW ACT

I.D. NUMBER:	16A-557
SUBJECT:	State Board of Accountancy - Commissions and Referral Fees
AGENCY:	DEPARTMENT OF STATE

TYPE OF REGULATION

Proposed Regulation

X Final Regulation

Final Regulation with Notice of Proposed Rulemaking Omitted

120-day Emergency Certification of the Attorney General

120-day Emergency Certification of the Governor

Delivery of Tolled Regulation
a. With Revisions b. Without Revisions

RECEIVED
2000 OCT 30 AM 11:38
REGULATORY REVIEW COMMISSION

FILING OF REGULATION

DATE	SIGNATURE	DESIGNATION
10-30-00	[signature]	HOUSE COMMITTEE ON PROFESSIONAL LICENSURE
OCT 30 2000	[signature]	SENATE COMMITTEE ON CONSUMER PROTECTION & PROFESSIONAL LICENSURE
10/30/00	[signature]	INDEPENDENT REGULATORY REVIEW COMMISSION
		ATTORNEY GENERAL
		LEGISLATIVE REFERENCE BUREAU

October 6, 2000