Regulatory Analysis Form

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REVIEW COMMISSION

Bush

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**

Secondar ontact: **Joyce McKeever, Deputy Chief Counsel, 783-7200**

(6) Type of Rulemaking (check one)

X Proposed Rulemaking
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 would require licensed certified public accountants and licensed public accountants in public practice who receive commissions to notify the Board and peer reviewers of such fact; to acquire and maintain in good standing any licenses required by other governmental or regulatory bodies relating to the receipt of commissions; to disclose commissions in client
(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.

(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 would help to ensure that licensees who receive commissions and referral fees do not place their personal financial interests above those of their clients.

(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 would 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 would 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, 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. Copies of the comments are attached collectively as Attachment 1.

(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 estimate the costs associated with compliance with the regulations (e.g., acquisition of other relevant licenses, documentation of disclosures, retention of workpapers). The principal cost may well be the loss of commission opportunities in situations where licensees are prevented by the regulations from referring commission-based products and services to parties who can exercise significant influence over the licensees' attest clients; such lost commission opportunities cannot be quantified.

Regulatory Analysis Form

(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. A political subdivision could retain the same licensee to perform audits of financial statements and to manage a pension or retirement plan so long as the licensee's compensation was not commission-based.

(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 would 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 would 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	$534,305.83	$579,731.92	$652,167.04 (est.)	$682,000 (est.)

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

The regulations would benefit the public by ensuring that licensees who collect commissions or accept or pay referral fees do not do so at the expense of their clients' financial interests. 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, an earlier version of the regulations contained a provision requiring a licensee who receive commissions to complete a minimum number of continuing education hours in the subject area or areas for which commissions are received. The Board later deleted the provision as unnecessary. An earlier version of the regulations also contained a prohibition against a licensee receiving a commission from any individual or entity that could impair the licensee's independence, in fact or in appearance, with regard to an attest client. The Board later deleted the provision as too vague, replacing it with a prohibition that references the precisely defined concept of "significant influence."

(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 is not aware of any states that have requirements similar to those set forth in the regulations.

The Board has no reason to believe that the regulations would 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 would 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 will consider comments from the public at its regularly scheduled meetings at 116-124 Pine Street in Harrisburg. The Board meets every month except February and March.

(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 would require licensees to notify the Board if they receive commissions; to make written disclosures of commissions and referral fees in their engagement and representation letters; and to keep workpapers that document the 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 would 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 would 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)

engagement and representation letters; to maintain workpapers that document the basis for recommending particular products and services to clients; and to refrain from receiving commissions, except in narrowly tailored circumstances, from individuals or entities that can exercise significant influence over the operating, financial or accounting policies of the licensees' attest clients. The regulations also would require licensees who accept or pay referral fees to disclose the fees in client engagement and representation letters.

PICPA

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September 11, 1998

...ing Division

Steven Wennberg, Counsel
State Board of Accountancy
116 Pine Street
P.O. Box 2649
Harrisburg, PA 17105-2649

Re: Exposure Draft of Proposed Commission and Referral Fee Regulation

Dear Steve:

On behalf of the PICPA Professional Ethics Committee, I have reviewed the above-referenced Exposure Draft and offer the following comments.

Section (d) – The PICPA does not find it necessary to differentiate CPE hours for licensees who receive commissions. Licensees who perform services in the areas of litigation support, forensic accounting, estate planning, etc. are not required to obtain specified hours in their practice areas and, as such, there is no reason to require licensees receiving commissions to obtain CPE in subject areas for which the commissions are received. Licensees are required by regulation to obtain hours which contribute to their professional competence. Other than the existing requirement for 16 hours in accounting and auditing subjects and 8 hours in taxation subjects, licensees should be able to choose programs related to their areas of practice which contribute to their professional competence. To impose a further breakdown of CPE hours in addition to that already required will become a reporting problem which the State Board may not be able to administer. As an alternative, we would suggest that if disciplinary matters come before the State Board, they may impose a specified number of CPE hours to be completed in subject areas related to the violation, similar to directing a licensee to complete specific courses in the matter of a violation of technical standards. The State Board would then not be bound by a regulation that would be difficult to monitor, and a licensee would be free to choose programs most suited to increase his/her level of professional competence.

Section (g) – The workpapers requirement to document "discussions regarding the client's needs, the investment strategies considered, and the basis for the investment strategy recommended by the licensee" is too vague. There is no guidance provided in the regulation concerning what would be considered an adequate level of documentation. Would a financial planning questionnaire determining risk tolerance, etc. be sufficient to document discussions, or would the licensee be required to maintain copious notes? Although the PICPA supports workpaper documentation, further guidance is required to establish minimum levels of documentation.

Attachment 1

Section (h) – The PICPA does not agree with the imposition of the independence standard with respect to the receipt of commissions. Section (h) is ambiguous and vague at best. Neither the AICPA or PICPA rules regarding receipt of commissions are linked to the independence rules unless the licensee is providing an attestation service to the client. If a licensee provides investment services to the shareholder of an attest client, and receives a commission as compensation from that shareholder or a third party, it is deemed a separate engagement. To link the two separate engagements could pose a legal issue for the State Board as independence is not defined in either the statute or the existing regulations. In fact, the existing independence regulations do not refer to commissions, and are written to include attest activities only. Providing investment services to shareholders of attest clients would not be considered an attest activity.

Under this draft regulation, a licensee would be at risk because of the vagueness of the language and the fact that nowhere in the independence rules is there a reference to receipt of commissions. A licensee would not be able to determine how independence might be impaired because there is no measurement standard. If the State Board chooses to create a regulation linking attest engagements with investment service for shareholders of the attest client, it needs to define the parameters. For instance, imposition of a requirement of significant influence as defined in the AICPA/PICPA Codes of Professional Ethics (enclosed) would be a definitive example of criteria that could result in the receipt of a commission from an individual shareholder possibly impacting independence with respect to the attest client. The PICPA strongly suggests that Section (h) be deleted or changed to incorporate significant influence if the State Board deems it necessary to try to restrict receipt of commissions in certain circumstances.

Thank you for the opportunity to provide these advance comments to the State Board regarding this regulation. If I can be of further assistance, please feel free to contact me.

Sincerely,

Mike Colgan

Michael D. Colgan, CAE
Assistant Director

Pennsylvania Society of Public Accountants

Executive Office • 900 North Second Street • Harrisburg, PA 17102
1(800) 270-3352 • (717) 234-4129 • FAX (717) 234-9556

September 15, 1998

Steven J. Wennberg, Counsel
Pennsylvania State Board of Accountancy
116 Pine Street
P.O. Box 2649
Harrisburg, PA 17105-2649

Dear Mr. Wennberg:

The following comments are being submitted in response to exposure draft #16A-557 regarding commissions, and exposure draft #16A-555 regarding program sponsors as outlined in your letter dated August 25, 1998. This is the second letter of two being submitted by the PSPA. We again thank you for the opportunity to comment on these issues.

Exposure Draft #16A-557

Section 11.24(h)

Section 12(p)(1)(i) of Act 140 prohibits licensees from accepting a commission for the sale of a product or service if the licensee "performs an audit or review" for that client. However, according to the language in Section 12(p)(1)(ii) of Act 140, a licensee is prohibited from accepting a commission if preparing a compilation for the client ***only if*** *"the licensee expects or reasonably might expect, that a third party will use the financial statement and the licensee's compilation report does not disclose a lack of independence."* The language set forth in Act 140 as it relates to commissions is clear and unambiguous.

The Board, by using the word "attest" to describe those activities for which commissions would be prohibited, is in direct conflict with the language in Act 140. The word attest is defined in the definition section of Act 140 to include compilations, reviews, and audits. Section 12(p)(i) of Act 140 clearly contains two subsections because not all of the attest activities prohibit a licensee from accepting a commission.

It is PSPA's position that Subsection (h) of Section 11.24 of exposure draft #16A-557 should be stricken from the regulations as it is in direct conflict with Section 12(p)(1)(ii) of Act 140.

Section 11.24(b)
The PSPA opposes Subsection (b) of Section 11.24 of the exposure draft. Through the imposition of this subsection the board is attempting to hold licensees who are taking commissions to more restrictive requirements than other licensees.

It is unclear the purpose this information would serve to the Board. It is possible that this information could be used in a discriminatory way against those licensees who accept a commission. We believe that the interests of the public are protected by subsections (c-g) of Section 11.24 of this exposure draft, and the imposition of subsection (b) is unnecessary.

Exposure Draft #16A-555

Section 11.69.1(b) Approval of program sponsors.
It is the position of the PSPA that in additional to those program sponsors approved by NASBA, state and national accounting societies and institutes should be exempt from submitting an application to approval by the Board.

The procedures for becoming an approved sponsor are unclear as they appear in Section 11.69.1. We request additional, more detailed information regarding the information that is required to the Board with the application for program sponsorship, and the timing of such information. For example, state organizations such as the PSPA offer over sixty different CPE programs throughout the course of a year, and not all of these programs are set up a year in advance. Often two-hour dinner meetings may not be confirmed until a month before the presentation. The language in 121.69.1 is unclear as to how this type of circumstance would be handled by the program sponsor.

If you have any questions or if you need additional information please do not hesitate to contact our Executive Office at 1-800-270-3352.

Sincerely,

Neil C. Trama, Jr.

Neil C. Trama, Jr., PA
PSPA President

concurrently provides commission-based services, if the CPA discloses a lack of independence in the compilation report. Section 12(p)(1) prohibits a CPA from receiving commissions where the CPA performs:

> (I) an audit or review of a financial statement;
>
> (II) a compilation of a financial statement when the licensee expects, or reasonably might expect, that a third party will use the financial statement and the licensee's compilation report does not disclose a lack of independence; and
>
> (III) an examination of prospective financial information. (*emphasis added*)

Accordingly, by precluding the CPA from concurrently providing commission-based services to and performing an "attest function" for a client, Section (h) appears to improperly prohibit a CPA from providing a compilation in which the CPA discloses a lack of independence, in conflict with Section 12(p)(1)(II), above.

Based on the apparent conflict between the language in proposed Section (h) and the existing language of Act 140, Section 12(p), we respectfully request that Section (h) be stricken or, alternatively, that the following clarifying language be added to Section (h):

> For purposes of section 12(p)(1) of this act, a licensee who performs an attest function for a client, except as set fourth in Section 12(p)(1)(II), may not receive a commission from any individual or entity that could impair the licensee's independence in fact or the appearance of independence with regard to the client.

As a side note, the term "activity" might be more suitable than "function" so as to be consistent with Section 2 of Act 140 (defining "attest activity", see above).

Thank you for your consideration. Should you need additional information or if we may answer any questions, please do not hesitate to call.

Yours respectfully,

Bredt Norwood

Bredt Norwood
General Counsel
H.D. Vest Financial Services

HD VEST
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September 18, 1998

RECEIVED
SEP. 21 1998
BPOA LEGAL COUNSEL

Mr. Kevin Mitchell
Chairman
State Board of Accountancy
116 Pine Street, Second Floor
P.O. Box 2649
Harrisburg, Pennsylvania 17101

Dear Mr. Mitchell:

We are writing today to express our concern with the language proposed in Exposure Draft 16A-557 section (h). We believe this proposed regulation clearly falls outside the scope and intent of Act 140 dealing with the regulation of Certified Public Accountants ("CPAs") as enacted by the General Assembly in 1996.

Section (h)

Section (h) of the exposure draft purports to prohibit CPAs from receiving commissions from clients to whom they provide attest services, stating:

> For purposes of section 12(p)(1) of this act, a licensee who performs an attest function for a client may not receive a commission from any individual or entity that could impair the licensee's independence in fact or the appearance of independence with regard to the client. (*emphasis added*)

"Attest function" is not defined in Pennsylvania's accountancy statutes or regulations. Presumably, however, it is synonymous with the term "attest activity," defined in Section 2 of Act 140, which states:

> Attest Activity. An examination, audit, review, compilation, or other agreed upon procedure with respect to financial information, together with the issuance of a report expressing or disclaiming an opinion or other assurance on the information. (*emphasis added*)

If the term "attest function" is the same as "attest activity," the scope of proposed section (h) is overly broad and conflicts with Section 12(p)(1)(II) of Act 140. Specifically, section (h) would prohibit a CPA from providing a "compilation" to a client for whom the CPA provides commission-based services because "compilation" is included in the definition of "attest" activity." However, Section 12(p)(1)(II) allows a CPA to prepare a compilation for a client to whom the CPA

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OCT 13 1998
BPOA LEGAL COUNSEL

October 7, 1998

Steven Wennberg, Counsel
PA State Board of Accountancy
116 Pine Street
P.O. Box 2649
Harrisburg, PA 17105-2649

RE: Exposure Draft of Proposed Commission & Referral Fee Regulation

Dear Attorney Wennberg,

At a recent conference of the Pa. Institute of CPA's (PICPA), we were given a copy of the above referenced proposal.

The header for the regulation section contains both "Commissions" and "referral fees", yet only subsections a) and f) language contain both terms. Subsections b), c), d), e), g), and h) cite only "commissions." Are all of the subsections (viz., a) through l)) meant to apply to "referral fees" also? If not, would clarifying language such as, "but not referral fees" be worth consideration.

Thank you for your consideration.

Sincerely,

RP O'Polka

Richard P. O'Polka, CPA/PFS, CFP

PICPA

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January 12, 1999

Thomas J. Baumgartner, CPA
Chairman
Pennsylvania State Board of Accountancy
P.O. Box 2649
Harrisburg, PA 17105-2649

Dear Mr. Baumgartner:

The Pennsylvania Institute of CPAs ("PICPA") appreciates the opportunity to comment on the State Board of Accountancy's (the "Board") proposed regulations on commissions and referral fees included in Title 49, Part I, Subpart A., Chapter 11. This letter was prepared by the PICPA's Professional Ethics Committee at the request of PICPA Council ("Council").

Board's Position on Significant Influence

PICPA Council is opposed to the Board's current position on the issue of "significant influence" as described in section 11.24 (g). According to our understanding of the proposed regulations, this section would prevent a CPA from accepting a commission from an individual or entity that can exercise significant influence over the operating, financial, or accounting policies of an attest client. We believe that this restriction may be excessive as well as unnecessary.

Many CPAs provide services in the areas of tax consultation and personal financial planning to the owners of closely held businesses. These services may involve planning aspects that go beyond the personal finances of the individual and harmonize with the tax and business strategies of the related business entity. Such relationships – where clients seek coordinated financial advice on both business and personal matters - have existed for many years and are viewed as efficient by the marketplace. These relationships do not cause the accountant to lose his/her independence nor hamper his/her ability to perform attest services for the related business entity. The Council does not believe that commissions received in connection with the provision of services to such individuals should cause the CPA to be unable to provide attest services to a related entity. Furthermore, we believe that the disclosure provisions of the law and regulations with respect to commissions provide adequate protection to the public and all parties, especially when considering that this matter is almost exclusively applicable to small, closely held businesses.

Consistency with the Rules of Other Related Organizations

The Council is also concerned with maintaining consistency with respect to similar rules and regulations of various regulatory bodies and organizations. We believe it important that CPAs have one set of standards to follow where practical, rather than a number of conflicting rules. The Council also believes that Pennsylvania CPAs should not be placed at a competitive disadvantage with respect to CPAs operating under the rules of several other states. It is for these reasons that PICPA Council initially suggested that Pennsylvania's new CPA statute adopt the rules for commissions and contingent fees that were previously adopted by the AICPA in 1991. We are now concerned that these proposed regulations will cause licensees to be confused about which situations permit the acceptance of commissions and which do not.

As you may know, the AICPA has recently proposed rulings under Rule 302 and Rule 503 of the Code of Professional Conduct concerning the acceptance of commissions and referral fees. One of these proposed rulings entitled "*Commission and Contingent Fee Arrangements With Nonattest Client*" would allow a CPA to accept a commission or contingent fee in connection with services performed for entities related to attest clients (including owners, employees, employee benefit plans, etc.), so long as the proper disclosures are made to all parties. This position was reached by the AICPA's Professional Ethics Executive Committee because that committee considers the owners, employees, and similar entities to be separate clients from the attest client for the purposes of applying Rule 302 and Rule 503. The PICPA is expected to adopt this same position when the Professional Ethics Committee considers the proposed ruling later this year.

Therefore, in light of the above information, we respectfully request that the Board reconsider its position on the proposed regulations with respect to commissions and referral fees.

We appreciate your consideration of our comments. We are available to discuss any of these comments with the Board or Board staff at your convenience.

Very truly yours,

James R. Heasley, CPA

James R. Heasley, CPA, Chairman
Professional Ethics Committee

c: Lewis E. Elicker, III, CPA, PICPA President
Steven J. Wennberg, Esq.
Donna J. Thorpe

CDL-1

FACE SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU

(Pursuant to Commonwealth Documents Law)

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REVIEW COMMISSION

DO NOT WRITE IN THIS SPACE

#2101

Copy below is hereby approved as to form and legality. Attorney General

BY: Cristina S. Caspson

(DEPUTY ATTORNEY GENERAL)

FEB 15 2000

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

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: Gregory E. Dunlap

2/3/00

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.

NOTICE OF PROPOSED 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

The State Board of Accountancy proposes to amend 49 Pa. Code §11.24 (relating to commissions) as set forth in Annex A.

Background

Section 11.24, which was adopted in 1970 and amended in 1980, currently provides that a licensee (i.e., a certified public accountant, public accountant or public accounting firm) may not pay a commission to obtain a client or accept a commission for referring a client to the products and services of others. The section does not prohibit payments for the purchase of the assets of an accounting practice, retirement payments to former practitioners, or payments to the heirs and estates of retired practitioners.

Section 11.24 was superseded by 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). Section 12(p)(1) of the CPA Law permits a licensee in public practice to receive a commission – defined as compensation for recommending or referring to a client a product or service to be supplied by another person – provided the licensee or the licensee's firm does not also perform any of the following attest activities for the client: (i) audit or review of a financial statement; (ii) compilation of a financial statement, when it is reasonably expected that a third party would use the financial statement and there is no disclosure of lack of independence, or (iii) examination of prospective financial information. Section 12(p)(3) of the CPA Law permits a licensee to pay or accept a referral fee, which is defined as compensation paid to a licensee for recommending another licensee's professional services. Sections 12(p)(2) and 12(p)(3) of the CPA Law require a licensee to disclose to a client payment or receipt of a commission or referral fee. Section 12(p)(4) of the CPA Law requires that the disclosure be clear, conspicuous and in writing; state the amount of the commission or referral fee or the basis on which its computed; and be made, in the case of a commission, at or before the time when the recommendation or the referral of the product or service is made, or, in the case of a referral fee, at or before the time the client retains the licensee to whom the client has been referred. Section 12(p)(4) of the CPA Law also directs the Board to promulgate regulations specifying the terms and manner of disclosure. Section 12(p)(5) of the CPA Law exempts the same three categories in the current §11.24 and adds a fourth, incentive or bonus payments to a licensee by the licensee's employing firm.

The Board's proposal is intended to revise §11.24 so that it is complementary of the provisions set forth in Section 12(p) of the CPA Law.

Description of Amendments

The amendments would delete the existing language in §11.24, which prohibits commissions and referral fees absolutely, and replace it with seven new subsections.

General. Subsection (a) would provide that a licensee is permitted to receive commissions or to accept or pay referral fees subject to the requirements of Section 12(p) of the CPA Law and this section.

Notification to Board. Subsection (b) would require a licensee who receives or intends to receive commissions to report such fact on the application for biennial renewal of licensure. The information would assist the Board in determining which licensees require monitoring to ensure compliance with disclosure and other requirements.

Cooperation with peer reviewers. Subsection (c) would require a licensee who receives commissions and who is subject to peer review under Section 8.9 of the CPA Law, 63 P.S. §9.8i, to furnish peer reviewers with the necessary documentation to establish the licensee's compliance with Section 12(p) of the CPA Law and this section. A licensee who sells commission-based products or services to attest clients will not receive an unqualified peer review report.

Related licensure/registration. Subsection (d) would require a licensee, prior to receiving commissions, to acquire and maintain in good standing any license or registration required by any governmental or regulatory agency for receiving commissions. Licensees who sell securities, for example, may need to be registered with the Pennsylvania Securities Commission or the National Association of Securities Dealers.

Disclosure to client. Subsection (e) would require a licensee who receives commissions or who accepts or pays referral fees to make the disclosures required by Section 12(p)(4) of the CPA Law in engagement or representation letters that are signed by the clients. This requirement would help to ensure that clients receive meaningful and timely disclosures, and would provide a context in which clients may evaluate the commissions or referral fees in connection with other fees charged by the licensee.

Workpapers. Subsection (f) would require a licensee who receives commissions to maintain workpapers that document discussions regarding the clients' investment needs, the investment strategies considered, and the bases for the investment strategies recommended by the licensee. This requirement would ensure that a licensee exercise professional judgment in the course of recommending or referring commission-based products or services to clients. A licensee's referral of a client to the public accounting services of another licensee generally does not involve the exercise of professional judgment.

Attest client. Subsection (g) would provide that for purposes of Section 12(p)(1) of the CPA Law, a licensee who performs an attest activity for a client (except for a compilation of financial statements accompanied by a disclosure of lack of independence as permitted under Section 12(p)(ii) of the CPA Law), 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 client's operating, financial and accounting policies. "Significant influence" would include, but not be limited to, situations in which the individual or entity (1) is connected with the client as a promoter, underwriter, voting trustee, general partner or non-honorary director; (2) is connected with the client in a policy-making 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; or (3) 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.

This subsection addresses the situation, not specifically dealt with in Section 12(p)(1) of the CPA Law, where a licensee receives a commission for a product or service sold to an individual or entity that, although not an attest client of the licensee, can nevertheless directly and substantially impact the business affairs of another client for which the licensee performs attest services. An example would be where a licensee has a two-member partnership as an attest client, and the licensee receives a commission on the sale of a product or service to a nonattest client that is a 50% partner in the partnership. The Board believes that a licensee's receipt of a commission in such circumstances could have an adverse impact on the licensee's independence with respect to the attest client. The Board's proposed "significant influence" standard is derived verbatim from the American Institute of Certified Public Accountants' 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).

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' principal fiscal impact on the regulated community would be the loss of potential commissions in situations where, as set forth in the proposed §11.24(g), the party to whom a licensee desires to recommend a commission-based product or service is in the position of exercising significant influence over an attest client of the licensee. The Board has no way estimating the financial cost to licensees of lost commission opportunities. The amendments would not have a fiscal impact on the Commonwealth's agencies or its political subdivisions.

The amendments would 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 would require the Board to revise its biennial renewal form to include a question about whether the licensee receives commissions; the Board intends to use this information for the purpose of monitoring compliance with the amendments' other requirements. The amendments would 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 amendments, solicited comments from the major professional organizations that represent certified public accountants and public accountants in Pennsylvania.

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 this notice of proposed rulemaking to the Independent Regulatory Review Commission, the Senate Standing Committee on Consumer Protection and Professional Licensure, and the House Standing Committee on Professional Licensure. The Board also provided the IRRC and the Committees with copies of a regulatory analysis form prepared in compliance with Executive Order 1996-1. Copies of this form are available to the public upon request.

If the IRRC has objections to any portion of the proposed amendments, it will notify the Board within 10 days following the close of the Committees' review period, specifying the regulatory review criteria that have not been met. The Regulatory Review Act sets forth procedures that permit the IRRC, the General Assembly and the Governor to review any objections prior to final adoption of the amendments.

Public Comment

The Board invites interested persons to submit written comments, suggestions, or objections regarding the proposed amendments to Steven Wennberg, Esq., Counsel, State Board of Accountancy, P. O. Box 2649, Harrisburg, PA 17105-2649 within 30 days following publication of this notice of proposed rulemaking 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 <u>and referral fees</u>.

<u>(a) *General*.</u> [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.] <u>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.</u>

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

<u>(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 to establish compliance with section 12(p) of the act and this section.</u>

<u>(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 body for the purpose of receiving commissions.</u>

<u>(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.</u>

<u>(f) *Workpapers.* A licensee who receives a commission shall maintain workpapers that</u>

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, but is not limited to, 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 policy-making 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

February 23, 2000

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

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

Dear Chairman McGinley:

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

A notice of proposed rulemaking will be published in the Pennsylvania Bulletin on March 4, 2000, triggering a public comment period that ends April 3, 2000.

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

Sincerely,

Thomas J. Baumgartner CPA

Thomas J. Baumgartner, Chairman
State Board of Accountancy

TJB:SW:apm
Enclosure

cc: Hon. Kim Pizzingrilli, Secretary of the Commonwealth
Department of State

C. Michael Weaver, Deputy Secretary for Regulatory Programs
Department of State

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

Joyce McKeever, Deputy Chief Counsel
Department of State

Dorothy Childress, 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

RECEIVED
2000 FEB 23 PM 3:04
INDEPENDENT REGULATORY REVIEW COMMISSION

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

TYPE OF REGULATION

X Proposed Regulation

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

FILING OF REGULATION

DATE	SIGNATURE	DESIGNATION
2-23-00	[signature]	HOUSE COMMITTEE ON PROFESSIONAL LICENSURE
2/23/00	Tammy Weaver	SENATE COMMITTEE ON CONSUMER PROTECTION & PROFESSIONAL LICENSURE
2/23/00	[signature]	INDEPENDENT REGULATORY REVIEW COMMISSION
		ATTORNEY GENERAL
2/23/00	Mayra Casas	LEGISLATIVE REFERENCE BUREAU

February 16, 2000