

NOTICE OF ADOPTION

Definition of Unprofessional Conduct in the Practice of Public Accountancy

I.D. No. EDU-16-06-00018-A

Filing No. 783

Filing date: June 23, 2006

Effective date: July 13, 2006

PURSUANT TO THE PROVISIONS OF THE State Administrative Procedure Act, NOTICE is hereby given of the following action:

Action taken: Amendment of section 29.10(a), (d), (e), (f) and (g) of Title 8 NYCRR.

Statutory authority: Education Law, sections 207 (not subdivided); 6502(1) and (3-a); 6504 (not subdivided); 6506(1); 6509(9); 6510(8); and 7401 (not subdivided)

Subject: Definitions of unprofessional conduct in the practice of public accountancy.

Purpose: To prescribe definitions of unprofessional conduct in the practice of public accountancy by updating the names of entities that promulgate generally accepted auditing standards and generally accepted accounting principles, establishing reporting requirements, and setting forth definitions of unprofessional conduct based upon actions of the United States Securities and Exchange Commission (SEC) or the Public Company Accounting Oversight Board (PCAOB).

Text of final rule: 1. Paragraph (7) of subdivision (a) of section 29.10 of the Rules of the Board of Regents is amended, effective July 13, 2006, as follows:

(7) permitting the public accountant's name to be associated with statements purporting to show financial position or results of operations in such a manner as to imply that he or she is acting as an independent certified public accountant or public accountant, unless:

(i) the licensee has complied with generally accepted auditing standards. The State Board for Public Accountancy may consider statements on auditing standards promulgated by [an organization whose standards are generally accepted by other licensing jurisdictions] *the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board for licensees subject to such requirements, or a recognized national accountancy organization whose standards are generally accepted by other regulatory authorities* in the United States, including but not limited to[:] the American Institute of Certified Public Accountants, to be interpretations of generally accepted auditing standards. Departures from such standards, or other standards considered by the State Board to be applicable in the circumstances, must be justified by a licensee who does not follow them; and

(ii) the licensee expresses an opinion on financial statements or financial data presented in conformity with generally accepted accounting principles. The State Board for Public Accountancy may consider those

principles promulgated by [an organization whose principles are generally accepted by other licensing jurisdictions] *a recognized national accountancy organization whose standards are generally accepted by other regulatory authorities* in the United States, including but not limited to: [the American Institute of Certified Public Accountants and] the Financial Accounting Standards Board, the Government Accounting Standards Board, and the International Accounting Standards Board, to be generally accepted accounting principles. If financial statements or data contain departures from generally accepted accounting principles but the licensee can demonstrate that the financial statements or data would have been misleading had generally accepted accounting principles been followed, the licensee's opinion should describe the departure, its approximate effect if practicable, and the reasons why compliance with generally accepted accounting principles would have otherwise been misleading;

2. Paragraph (13) of subdivision (a) of section 29.10 of the Rules of the Board of Regents is repealed, effective July 13, 2006.

3. Subdivision (d) of section 29.10 of the Rules of the Board of Regents is added, effective July 13, 2006, as follows:

(d) *The definitions of unprofessional conduct prescribed in sections 29.1 and 29.10 of this Part that apply to licensees shall also apply to public accountancy firms, meaning any form of business organization that is authorized to engage in the practice of public accountancy and is subject by law to Regents disciplinary proceedings and penalties in the same manner and to the same extent as licensees, unless public accountancy firms are specifically exempted from the definitions of unprofessional conduct in such sections of this Part.*

4. Subdivision (e) of section 29.10 of the Rules of the Board of Regents is added, effective July 13, 2006, as follows:

(e) *Reportable events.*

(1) *For purposes of this subdivision, public accountancy firm shall have the meaning defined in subdivision (d) of this section.*

(2) *Unprofessional conduct in the practice of public accountancy shall include failure of a licensee or public accountancy firm to submit a written report, as prescribed in paragraph (3) of this subdivision, to the department within 45 days of the occurrence of any of the following events, even though all available appeals have not yet been exhausted, unless exempted from disclosure pursuant to paragraph (5) of this subdivision or excused for good cause as determined by the department, such as a circumstance beyond the licensee's or public accountancy firm's control that prevented timely compliance:*

(i) *conviction of a licensee, a registered partnership, or public accountancy firm in New York State or any other jurisdiction of a crime that constitutes a felony or misdemeanor in the jurisdiction of conviction. For purposes of this subparagraph, conviction shall include a plea of guilty or no contest, or a verdict or finding of guilt that has been accepted and entered by a court of competent jurisdiction;*

(ii) *receipt of a court decision awarding a monetary judgment in excess of twenty-five thousand dollars in a civil action brought in a court of competent jurisdiction or an award in excess of twenty-five thousand dollars in an arbitration proceeding in which the licensee, the registered partnership, or public accountancy firm is found to be liable for:*

(a) *negligence, gross negligence, recklessness, or intentional wrongdoing relating to the practice of public accountancy in New York State;*

(b) *fraud or misappropriation of funds relating to the practice of public accountancy in New York State;*

(c) *breach of fiduciary responsibility relating to the practice of public accountancy in New York State; or*

(d) *preparation, publication, and/or dissemination of false, fraudulent, and/or materially incomplete or misleading financial statements, reports, or information relating to the practice of public accountancy in New York State;*

(iii) *receipt of written notice of imposition of a disciplinary penalty upon the licensee, the registered partnership, or public accountancy firm, including but not limited to, censure, reprimand, sanction, probation, monetary penalty, suspension, revocation, or other limitation on practice, relating to the practice of public accountancy, issued by:*

(a) *the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board;*

(b) *another agency of the United States government that regulates the practice of public accountancy;*

(c) *an agency of the government of another state or territory of the United States that regulates the practice of public accountancy; or*

(d) *an agency of the government of another country that regulates the practice of public accountancy;*

(3) The report to the department shall consist of the following:

(i) for a conviction as prescribed in subparagraph (i) of paragraph (2) of this subdivision, the report shall consist of a copy of the certificate of conviction, or comparable document of the court;

(ii) for a court decision or arbitration award as prescribed in subparagraph (ii) of paragraph (2) of this subdivision, the report shall consist of a copy of the court decision or arbitration award and any findings of facts or special verdict form;

(iii) for a written notice of imposition of a disciplinary penalty upon the licensee, as prescribed in subparagraph (iii) of paragraph (2) of this subdivision, the report shall consist of a copy of the notice; or

(iv) in lieu of the documentation described in subparagraphs (i), (ii), or (iii) of this paragraph, a narrative statement on a form prescribed by the department setting forth information specified by the department, including but not limited to the date and jurisdiction of the court decision and/or judgment, conviction, arbitration award, or notice of imposition of disciplinary penalty, as applicable.

(4) A public accountancy firm shall be responsible for reporting reportable events relating to the public accountancy firm, and shall designate an individual to make such reports. An individual licensee shall be responsible for reporting those reportable events specifically relating to the licensee. Licensees who are partners in a registered partnership may designate an individual to report reportable events relating to the registered partnership, but each such licensee shall be responsible for ensuring the reporting of the reportable events.

(5) Failure to submit a report which is subject to a confidentiality order, clause or provision in a court decision or arbitration award under subparagraphs (i) or (ii) of paragraph (2) of this subdivision shall not be deemed to constitute unprofessional conduct under the following conditions:

(i) the court or arbitrator has included language in such decision that specifically provides that the decision shall not be reported to the department pursuant to this subdivision; or

(ii) the licensee or firm demonstrates to the satisfaction of the department that the licensee or firm explicitly informed the court or arbitrator in writing prior to execution of any confidentiality order, clause or provision of the duty to report such decision to the department and the effect of any confidentiality order, clause or provision on such duty of disclosure, and the confidentiality order, clause or provision does not expressly provide for disclosure to the department.

(6) Reports submitted to the department in accordance with this subdivision shall be files of the department relating to the investigation of possible instances of professional misconduct and shall be confidential in accordance with the provisions of subdivision (8) of section 6510 of the Education Law.

(7) Nothing in this subdivision shall have any effect upon the duty of the licensee or firm to respond fully to all questions on any re-registration application which shall become due, or to respond to written communications from the department pursuant to section 29.1(b)(13) of this Part.

5. Subdivision (f) of section 29.10 of the Rules of the Board of Regents is added, effective July 13, 2006, as follows:

(f) Unprofessional conduct in the practice of public accountancy shall include:

(1) having admitted guilt to or having been found guilty of improper professional practice or professional misconduct in a disciplinary proceeding brought by the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board, where the conduct upon which the finding or admission of guilt was based would, if committed in New York State, constitute professional misconduct under the laws of New York State, provided that in any adversary proceeding conducted pursuant to subdivision (3) of section 6510 of the Education Law, the individual licensee or public accountancy firm shall have the rights set forth in that subdivision; or

(2) having voluntarily consented to a revocation or temporary or permanent suspension of the authority to appear or practice as an accountant before the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board, or having voluntarily surrendered such authority; or having voluntarily consented to a revocation or temporary or permanent suspension from further association with any public accounting firm registered pursuant to Chapter 98 of Title 15 of the United States Code, or having voluntarily surrendered such authority; or having voluntarily consented to a revocation or temporary or permanent suspension of registration under Chapter 98 of Title 15 of the United States Code, or a voluntary surrender of such registration; all after a disciplinary action was commenced by the United States Securities and

Exchange Commission or the Public Company Accounting Oversight Board where any conduct charged resulting in the consent to such revocation or temporary or permanent suspension or surrender would, if committed in New York State, constitute professional misconduct under the laws of New York State; and where the date of such consent or surrender is on or after January 1, 2007. In any adversary proceeding conducted pursuant to subdivision (3) of section 6510 of the Education Law, the individual licensee or public accountancy firm shall have the rights set forth in that subdivision.

6. Subdivision (g) of section 29.10 of the Rules of the Board of Regents is added, effective July 13, 2006, as follows:

(g) Unprofessional conduct in the practice of public accountancy, as such practice relates to the audit in the practice of public accountancy of an issuer of publicly traded securities that is subject to the Federal Sarbanes-Oxley Act of 2002, shall include, for purposes of subdivision (f) of this section, a failure of a licensee or public accountancy firm, as appropriate, to meet the standards prescribed in the following provisions of Federal law: subdivisions (a), (b), (g), (h), (i), (j), (k), and/or (l) of section 78j-1 of Title 15 of the United States Code (United States Code, 2000 edition, Volume 7, and Supplement II, Volume 1 to the 2000 edition; Superintendent of Documents, U.S. Government Printing Office, Stop SSOP, Washington, DC 20402-0001; available at the NYS Education Department, Office of the Professions, 2M West Wing, Education Building, 89 Washington Avenue, Albany, NY 12234). To the extent that the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board have exempted or excepted licensees or public accountancy firms from these standards, such exemptions or exceptions shall also apply to the requirements of this subdivision.

Final rule as compared with last published rule: Nonsubstantive changes were made in section 29.10(e)(4).

Text of rule and any required statements and analyses may be obtained from: Anne Marie Koschnick, Legal Assistant, Office of Counsel, Education Department, State Education Bldg., Rm. 148, Albany, NY 12234, (518) 473-8296, e-mail: legal@mail.nysed.gov

Regulatory Impact Statement

Since publication in the *State Register* of the Notice of Proposed Rule Making on April 19, 2006, the proposed rule has been non-substantially revised as follows: in section 29.10(e)(4), third sentence, after the phrase "relating to," the word "he" is replaced with the word "the." This revision to the rule does not necessitate any changes to the Regulatory Impact Statement.

Regulatory Flexibility Analysis

Since publication in the *State Register* of the Notice of Proposed Rule Making on April 19, 2006, the proposed rule has been non-substantially revised as set forth in the Statement Concerning the Regulatory Impact Statement, submitted herewith. This revision to the rule does not necessitate any changes to the Regulatory Flexibility Analysis for Small Businesses and Local Governments.

Rural Area Flexibility Analysis

Since publication in the *State Register* of the Notice of Proposed Rule Making on April 19, 2006, the proposed rule has been non-substantially revised as set forth in the Statement Concerning the Regulatory Impact Statement, submitted herewith. This revision to the rule does not necessitate any changes to the Rural Area Flexibility Analysis.

Job Impact Statement

Since publication in the *State Register* of the Notice of Proposed Rule Making on April 19, 2006, the proposed rule has been non-substantially revised as set forth in the Statement Concerning the Regulatory Impact Statement filed herewith.

The purpose of the proposed amendment is to prescribe definitions of unprofessional conduct in the practice of public accountancy by updating the names of entities that promulgate generally accepted auditing standards and generally accepted accounting principles, establishing reporting requirements, and setting forth definitions of unprofessional conduct based upon actions of the United States Securities and Exchange Commission (SEC) or the Public Company Accounting Oversight Board (PCAOB).

The proposed amendment, as revised, establishes standards of practice for New York State licensed public accountants and public accountancy firms. It sets forth standards that licensees and firms must already meet pursuant to Federal law, and establishes violations of such standards as definitions of unprofessional conduct that could subject licensees and firms to professional discipline. In addition, the amendment, as revised, establishes a reporting requirement for events that relate to possible instances of professional misconduct. This amendment will not affect the number of jobs or employment opportunities in public accountancy or in

any other field. Because evident from the nature of the proposed amendment, as revised, that it will have no impact on jobs and employment opportunities, no further steps were needed to ascertain that fact and none were taken. Accordingly, a job impact statement is not required and one was not prepared.

Assessment of Public Comment

The proposed regulation was published in the *State Register* on April 19, 2006. Below is a summary of comments received by the State Education Department and the Department's response.

COMMENT: The reporting of a court decision, arbitration award, and notice of discipline should only be required after exhaustion of all appeals and expunged upon exoneration.

RESPONSE: The regulation requires licensees or firms to report to the Department prescribed events within 45 days, and failure to report constitutes unprofessional conduct. A licensee or firm must report the receipt of a court decision or an award in an arbitration proceeding in which the licensee, registered partnership, or public accountancy firm is found liable for negligence or wrongdoing relating to the practice of public accountancy in New York State, and must report the notice of the imposition of a disciplinary penalty upon the licensee, registered partnership, or public accountancy firm relating to the practice of public accountancy.

Convictions, court decisions, or determinations imposing disciplinary penalties are public information when rendered. Reporting them immediately will give the Department an opportunity to determine whether further investigation is appropriate, avoiding delay until appeals are over. If the court decision is ultimately upheld, the Department will be able to protect the public immediately from similar wrongdoing. As to expungement, the reports are maintained as investigatory documents, subject to the confidentiality provisions of Education Law section 6510(8). If disciplinary charges are not initiated, these reports will be destroyed in accordance with retention schedules for investigatory materials.

COMMENT: The monetary threshold, over \$25,000, for the triggering of the reporting of court decisions or arbitration awards is too low. We recommend that this threshold be increased to over \$150,000.

RESPONSE: The Department disagrees that the monetary threshold, over \$25,000, is too low. The regulation requires the licensee or firm to report a court decision or arbitration award in which the licensee or firm is found liable for over \$25,000 for negligence or wrongdoing relating to the practice of public accountancy in New York State. The monetary threshold protects the public. It ensures that reported cases are not trivial, but the threshold is not so high as to exclude significant cases.

COMMENT: The reporting of court decisions should be limited to decisions issued by courts in the United States or its territories. The reporting of disciplinary penalties should be limited to specifically named countries whose standards of due process and practice of accountancy are substantially equivalent to New York's.

RESPONSE: This is only a reporting requirement. It is unnecessary to limit the jurisdictions whose court decisions or findings of unprofessional conduct should be reported. A finding of unprofessional conduct relating to the practice of public accountancy by a foreign jurisdiction could provide valuable guidance to the Department in investigating possible instances of unprofessional conduct by a firm or licensee in New York.

COMMENT: The reports of administrative disciplinary actions (section 29.10[e][2][ii]) should relate to practice in New York State. Failure to include this geographic nexus raises constitutional concerns because the due process clause and the dormant commerce clause limit States' powers to regulate beyond their borders.

RESPONSE: This reportable event is reasonable. It requires the reporting of administrative disciplinary penalties relating to the practice of public accountancy. The Department will use this information to determine if in fact there is a nexus to New York and whether any further investigation is necessary.

COMMENT: Requiring the reporting of a conviction of a felony or misdemeanor is too broad without relating to the practice of public accountancy in New York State.

RESPONSE: Education Law section 6509(d) defines unprofessional conduct as being convicted of a crime under New York law, Federal law, or the law of another jurisdiction. Such crime need not relate to professional practice. The reporting requirement is reasonable because the conviction of a felony or misdemeanor may be professional misconduct regardless of the jurisdiction.

COMMENT: The proposed regulation would allow partners in registered partnerships to designate an individual to report reportable events but unreasonably holds each partner responsible for ensuring that events are reported.

RESPONSE: Partnerships registered pursuant to Education Law section 7408 must report the events. The licensees who are partners may designate an individual to report the events, but each licensed partner is responsible to ensure the reporting. The licensee will be permitted to discharge this responsibility by ensuring that an individual is assigned to making the reports and that reasonable monitoring and reporting procedures are in place. The Department will issue written guidance.

COMMENT: The Regents should revise the exception to the reporting requirement for court decisions or arbitration awards that are confidential. The requirements place an undue burden on the licensee or firm, may be unenforceable and invite unnecessary litigation.

RESPONSE: The regulation contains an exemption to the reporting requirement when a court or arbitrator has included language in a decision that specifically provides that the decision shall not be reported to the Department, and another exemption, which would require the licensee or firm to inform the court or arbitrator, prior to the execution of the confidentiality provision, of the duty to report the decision to the Department. Failure to notify the Department would not constitute unprofessional conduct if following notification, the court or arbitrator does not provide for disclosure to the Department. These requirements do not place an undue burden on the licensee or firm. They ensure that a court or arbitrator is aware of the reporting requirement before issuing the order. It is within the control of the licensee or firm to provide notice to the court, and therefore, there should be little or no conflict between the reporting requirement and a court order.

COMMENT: The confidentiality exemption to the reporting requirement requires the licensee to inform a court or arbitrator about a specific provision in the Regents Rules. Inadvertent errors may occur. It is unreasonable to expect judges or arbitrators throughout the country to include in their decisions explicit reference to the Department. An exemption without limitation should apply when a court or arbitrator makes its determination confidential.

RESPONSE: The regulation establishes reasonable conditions for a court or arbitration decision to be exempt from the reporting requirement, based upon confidentiality order or provision, as stated above. In the event of error, the licensee or firm may apply to the Department for an exemption for good cause (section 29.10[e][2]). These court decisions and arbitration awards have monetary judgments, making it unlikely that they will be subject to confidentiality orders because they have to be collected.

COMMENT: The confidentiality exception to reporting fails to include administrative determinations.

RESPONSE: The regulation requires the reporting of a disciplinary penalty relating to the practice of public accountancy issued by government administrative agencies. Normally, these determinations are public. In the unlikely event that the determination is confidential, the licensee or firm may apply to the Department for an exception for good cause.

COMMENT: The proposed regulation alters the presumption of innocence, and permits the finding of professional misconduct when the licensee or firm voluntarily consents, with no admission of guilt, to a revocation or suspension of authority to practice before the U.S. Securities and Exchange Commission (SEC) or the Public Company Accounting Oversight Board (PCAOB), where any conduct charged resulting in the consent would, if committed in New York State, constitute professional misconduct under the laws of New York State. The Department should not consider a voluntary settlement with no admissions or findings of guilt to constitute improper professional conduct, and any such conclusion may raise serious constitutional due process issues.

RESPONSE: The regulation defines as unprofessional conduct, having voluntarily consented to a revocation or suspension of the authority to practice before the SEC or PCAOB, after disciplinary action was commenced by one of these agencies and the underlying conduct charged resulting in the consent would if committed in New York State constitute professional misconduct under the laws of New York State. The regulation would apply to consents entered into on or after January 1, 2007. The licensees or firms will be on notice that they may be subject to State professional discipline based upon a voluntary consent to revocation or suspension of its authority to practice before the SEC or PCAOB.

Education Law section 6509(9) delegates to the Regents the authority to define professional misconduct in the practice of a licensed profession. The regulation defines unprofessional conduct in the practice of public accountancy in accordance with this statutory authority. In addition, the licensee or public accounting firm has all of the due process rights available under Education Law section 6510, including the right to explain its conduct for purposes of imposition of an appropriate penalty.

The proposed regulation was modeled after a provision defining professional misconduct in medicine (Education Law section 6530[9][d]). This provision like the proposed regulation defines professional misconduct as, *inter alia*, having a medical license revoked, suspended or having other disciplinary action taken by another State, or the licensee having surrendered his or her license after a disciplinary action was instituted by another State, but does not require a finding of guilt of the underlying charges. The Court of Appeals upheld this provision as providing sufficient due process, and rejected the contention that application of section 6530(9)(d) required proof of guilt of the out-of-state charges (*Matter of D'Ambrosio*, 4 NY3d 133 [2005]).

COMMENT: The provision that defines unprofessional conduct as a voluntary consent to a revocation or suspension of a licensee's or public accountancy firm's authority to practice before the SEC or PCAOB, based upon conduct charged resulting in the revocation or temporary or permanent suspension or surrender does not provide an appropriate measure of misconduct, unlike findings or admissions of misconduct. Disciplinary authorities may bring multiple charges in order to procure a settlement on a subset of charges.

RESPONSE: The regulation refers to "any conduct charged resulting in the consent to such revocation or temporary or permanent suspension or surrender" of authority to practice before the SEC or PCAOB. (Emphasis added.) Therefore, not all charges will be pertinent. The charges must result in the consent to the practice limitation. If the settlement document states that charges were dropped or not considered, they will not be pertinent in the misconduct proceeding.

COMMENT: The proposal would discourage settlement in SEC and PCAOB disciplinary proceedings. A New York licensee would be less likely to settle with the SEC or PCAOB, knowing that the Department could impose its own discipline based upon the original charges.

RESPONSE: As stated above, only the charges that result in the consent to the suspension or revocation of the authority to practice will be pertinent. These settlement cases will involve charges of a substantive nature in which the licensee or firm has agreed to relinquish authorization to practice. It is unlikely that a possible State disciplinary proceeding will have chilling effect on whether the licensee or firm agrees to settle these serious Federal cases.

COMMENT: The Department is incorrect in stating in the Regulatory Impact Statement that the regulation will not impose costs on licensees or firms, except for reporting costs. Monitoring for reportable events will impose significant costs. Legal costs can also be expected to increase as the regulations give rise to questions of application and make SEC and PCAOB settlements more complicated.

RESPONSE: The Department adequately estimated costs of the rule making in the Regulatory Impact Statement. This statement accurately reported that the only costs concern the reporting requirement and prorated costs per reportable event. It considered both costs for monitoring for reportable events and submitting the reports to the Department. The comment that the regulation will impose additional legal costs because it will give rise to questions of application and more complicated SEC and PCAOB settlements is speculative.