

**PROFESSIONAL ETHICS EXAM AND CONTINUING EDUCATION. CALIFORNIA
BOARD OF ACCOUNTANCY
DEPARTMENT OF CONSUMER AFFAIRS**

INITIAL STATEMENT OF REASONS

Hearing Date: No hearing date has been scheduled.

Subject Matter of Proposed Regulations: Professional ethics exam and continuing education

Sections Affected: Title 16, California Code of Regulations (CCR)¹, Division 1, sections 10, 10.1, and 87.1.

Background and Statement of the Problem:

The California Board of Accountancy (CBA) licenses, regulates, and investigates complaints against four different license categories in California, totaling approximately 111,000 licensees. These licensing categories include Public Accountant (PA), Certified Public Accountant (CPA), Accountancy Corporation (COR), and Accountancy Partnership (PAR). It is the CBA's duty to enforce and administer the Accountancy Act Chapter 1 (commencing with section 5000) of Division 3 of the Business and Professions Code (BPC). The CBA is authorized to establish necessary rules and regulations for the enforcement of the Accountancy Act and laws subject to its jurisdiction (BPC 5010).

The CBA's mission is to protect consumers by ensuring only qualified licensees practice public accountancy in accordance with established professional standards. One of the ways the CBA does this is by regulating entry and continuing practice in the profession by ensuring only those who are qualified are licensed to practice public accountancy.

CCR section 10 requires all CPA applicants to pass a CBA-approved examination in professional ethics no sooner than two years prior to the date on which they apply for licensure. The CBA-approved examination is the Professional Ethics Examination for Certified Public Accountants (PETH Exam) developed and administered by the California Society of Certified Public Accountants (CalCPA). The PETH Exam is a self-study course with an open-book, online examination. An applicant has one year to pass the exam after the date of purchase and may take the exam up to six times in that one-year period. If they are unsuccessful, they may re-purchase the course and exam one year after their prior purchase. Once the PETH Exam is passed, the credit remains valid for two years.

¹ All CCR references in this document are to sections within Division 1 of Title 16, unless otherwise specified.

BPC section 139 mandates the Department of Consumer Affairs (DCA) to conduct periodic evaluations of all licensing examinations administered by its boards and bureaus and to develop a policy regarding examination development and validation, and occupational analysis (OA).

DCA established the *Licensure Examination Validation Policy* (OPES-22-01) (Underlying Data #1) pursuant to BPC section 139. The policy goes on to state “occupational analyses and examination development studies are fundamental components of licensure programs. Licensure examinations with substantial validity evidence are essential in preventing unqualified individuals from obtaining professional licenses.”

The CBA requested that DCA’s Office of Professional Examination Services (OPES) complete the required comprehensive review of the Uniform CPA Examination (CPA Exam) and PETH Exam pursuant to BPC section 139. The purpose of the OPES review was to ensure that examination programs used for California CPA licensure comply with psychometric and legal standards. OPES relied upon the 2014 version of the *Standards for Educational and Psychological Testing (2014 Standards)* to perform their review of the following:

- OA
- Examination development and scoring
- Passing scores and passing rates
- Test administration and score reporting
- Test security procedures

OPES issued its reports in June 2023, concluding that sufficient evidence was found to support the continued use of the CPA Exam as a licensure exam, but the PETH Exam was not sufficiently supported by evidence and did not appear to meet the professional guidelines and technical standards outlined in the *2014 Standards* and BPC 139. OPES indicated they had significant concerns about the validity of using the PETH Exam for licensure decisions (Underlying Data #6).

The PETH Exam is a California-specific examination and is one of two exams (in addition to the CPA Exam) applicants must successfully pass to obtain a CPA license in California. To be a valid examination for licensure, the content assessed by the PETH Exam should be directly linked to CPA areas of practice in California identified by a current California OA and should not be duplicative of content covered by the national examination (CPA Exam).

OPES found that much of the professional ethics covered in the PETH Exam is redundant with the new CPA Exam that begins January 2024. Specifically, OPES found that only 13% of the PETH Exam content is California-specific and relates to California statutes and regulations not assessed on the CPA Exam.

In addition to the coverage of professional ethics on the CPA Exam, the CBA considered the following, which suggests that professional ethics are adequately covered both pre- and post-licensure:

- Academia has embedded ethics into its courses.
- In 2014, the CBA began requiring a minimum of 10 semester units in ethics study for licensure.
- In 2010, the CBA began requiring four hours of continuing education in ethics every renewal cycle.

For the PETH Exam results to be considered a valid basis for making CPA licensure decisions in California, the knowledge base tested on the examination must closely correspond to the knowledge required to perform entry level CPA practice activities safely and effectively across different settings in California. As indicated by the *2014 Standards*, this knowledge base is typically identified by conducting an OA. The results of the OA should directly inform the examination content outline (*i.e.*, test blueprint) in terms of important tasks and the knowledge that should be assessed through a licensure examination. OPES identified a lack of procedures (*e.g.*, California-specific OA) to document that the knowledge assessed on the PETH Exam is required for safe and effective entry level practice in California.

In addition to duplicative content between the PETH Exam and CPA Exam, OPES identified problems in the following areas that contributed to a concern with the validity of using the PETH Exam for licensure decisions: (a) OA; (b) examination development and scoring; (c) passing scores and passing rates; (d) test administrations and score reporting; and (e) test security procedures (Underlying Data #6). Most of the problems identified resulted from the open-book, online self-study format of the PETH Exam compared to a typical licensure examination format.

Licensure examination development and maintenance is complex and resource intensive. They require the oversight of examination development experts and psychometricians as well as multiple workshops with subject matter experts that represent the diversity of the CPA profession. These are not one-time activities but are performed on a continuous cycle. Additionally, a licensure examination would require a monitored, standardized administration process that would require the use of a testing facility.

Given the OPES finding, it was necessary for the CBA to take action to come into compliance with the OPES-22-01 policy and ensure that all licensure examinations required by the CBA meet technical and professional standards. To rectify this, the CBA opted to remove the requirement that applicants pass an examination on rules of professional ethics.

The CBA discussed how California statutes and regulations would be covered with the elimination of the requirement to pass an examination on rules of professional ethics.

Specifically, the 13% of the PETH Exam that is California-specific and is not covered by the CPA Exam.

An additional concern the CBA discussed was the loss of credit and/or money for those who have completed the PETH Exam and not yet applied it towards licensure, and those who have purchased the PETH Exam and not yet completed it.

The CBA considered the following options:

1. Pre-licensure Course - Require a pre-licensure course that covers California statutes and regulations (currently 13% of the PETH Exam).
2. Continuing Education (CE) - Require a post-licensure CE course that covers California statutes and regulations (currently 13% of the PETH Exam).

The CBA moved to initiate a rulemaking to eliminate the requirement for the PETH Exam prior to licensure and require newly licensed CPAs to complete a CBA-approved Regulatory Review CE course prior to their first license expiration date to address the concern that California laws and regulations may not be sufficiently covered following the elimination of the PETH as a licensure exam (Option 2 above). This would require an amendment to CCR sections 10 and 87.1.

Currently, CPAs must complete a Regulatory Review course every 6 years. This requirement begins on their first license expiration date, which means a newly licensed CPA could practice for more than six years prior to completing their first Regulatory Review course. Amending the Regulatory Review course requirement would place it within a newly licensed CPA's first 2 years of practice instead of six to eight years.

Regulatory Review courses must be pre-approved by the CBA prior to being offered as CE credit and must meet the requirements set forth in CCR section 87.9. The CBA currently has 37 approved courses available for licensees to choose from, with the various courses offered by multiple providers.

By eliminating the examination on rules of professional ethics and not requiring a pre-licensure course, the cost and time required to obtain a CPA license in California would be reduced and the possibility of an artificial barrier to licensure would be removed. A transition to requiring the Regulatory Review course earlier would not require significant time or financial investment from the CBA.

The proposed amendments address the lack of evidence that the PETH Exam is meeting professional and technical standards and the OPES finding that they had significant concerns with using the PETH Exam for licensure decisions. The proposed amendments also address the unintended consequences of eliminating the PETH Exam by:

- Requiring newly licensed CPAs take the Regulatory Review CE course to ensure coverage of California-specific rules and regulations.
- Temporarily recognize the PETH Exam as a self-study Regulatory Review CE

course to reduce the burden on those applicants who have already purchased the PETH Exam but will not need it for licensure.

Pursuant to CCR section 88, self-study courses are acceptable as CE if the course meets the following requirements:

- The program is based upon materials specifically developed for instructional use.
- The program meets the requirements of CCR sections 88(a), 88.1, and 88.2.
- The program is completed within one year of the date of purchase or enrollment.
- The licensee receives a passing score.

The PETH Exam is currently based on materials specifically developed for instructional use. Purchasers must take and pass an examination within one year of purchase. The PETH Exam meets most of the CBA's CE requirements and is appropriate for CE credit. The material covered in the PETH Exam is similar to the material covered in the CBA-approved Regulatory Review course, making the PETH Exam appropriate for Regulatory Review CE credit.

Anticipated benefits from this regulatory action:

Eliminating the PETH Exam requirement is supported by the OPES findings, eliminates a barrier to licensure that is not supported by evidence, and reduces applicant licensure costs.

Specific purpose of, and rationale form, each adoption, amendment, or repeal:

The proposed amendments would eliminate the requirement for CPA applicants to pass the PETH Exam prior to licensure and would add a new requirement that newly licensed CPAs must complete a CBA-approved Regulatory Review course before their first license expiration date.

1. **Section 10** is amended to add "Until [OAL: insert effective date of these regulations]."
 - A. Purpose: The proposed amendment will discontinue the requirement for a CPA to pass an examination in professional ethics as a requirement of licensure. Additionally, BPC 5092 is being removed from the reference section.
 - B. Rationale: The PETH Exam is currently used as the examination of professional ethics. The proposed amendment to eliminate the requirement is necessary given the CPA Exam includes professional ethics and there is a lack of evidence that the PETH Exam meets professional and technical standards. BPC 5092 became inoperable on January 1, 2014.
2. **Section 10.1** is added as follows: "Examination on Rules of Professional Conduct Transition. (a) Licensees who meet both of the following requirements may use a passing score on the CBA-approved examination in professional ethics toward two hours of technical continuing education as described in

Section 87.1: (1) Initial certified public accountant license was issued on or after [OAL: insert effective date of these regulations]. (2) CBA-approved professional ethics examination was purchased prior to [OAL: insert effective date of these regulations]. (b) This section shall become inoperative on [OAL: insert date that is two years from the effective date of these regulations]. NOTE: Authority cited: Sections 5010 and 5018, Business and Professions Code. Reference: Sections 5018, 5027, 5082, and 5093, Business and Professions Code.”

- A. Purpose: The proposed amendment will allow those who purchased the PETH Exam prior to the implementation of the proposed regulations to count those credits towards CE.
- B. Rationale: The proposed addition of section 10.1 is necessary to address the one-time impact to those who purchased the PETH Exam prior to the implementation of these regulations that eliminates it as a requirement. The two-year inoperative date was chosen given PETH Exam scores are valid for two years and establishing a consistent date allows for clear communication to applicants. Subsections (a)(1) and (a)(2) are necessary to ensure that only licensees who have purchased the PETH Exam prior to the effective date of these regulations, and not yet used it for licensure, may claim the PETH Exam as CE credit. After the effective date of the regulations, licensees who have not purchased the PETH Exam will be required to complete a CBA-approved Regulatory Review course.

The California-specific questions on the PETH Exam test knowledge that a licensee would gain through the completion of a Regulatory Review course. A passing score on the PETH Exam indicates the applicant/licensee has completed the PETH Exam and demonstrated sufficient knowledge of the California-specific laws and regulations contained within the PETH Exam. The CBA is maintaining the current passing score during the transition. The current passing score did not meet technical standards for a licensure exam because it was not linked to what a newly licensed CPA needs to know. That requirement is irrelevant for CE courses; therefore, the CBA intends to maintain the current passing score consistency and clarity.

The PETH Exam is part of a self-study course offered by CalCPA. The examination portion consists of 50 questions. CCR section 88.2(c)(1)(B) states that a self-study course may grant credit by counting the number of final examination questions, multiplying it by 1.85, and then dividing the total by 50. Using this method, the PETH Exam should be awarded 1.85 hours of CE. All CBA-approved Regulatory Review courses must be at least two-hours in length. The CBA has determined that rounding up to two hours of CE credit is appropriate for completion of the PETH Exam.

The note added at the end of the section cites the CBA’s authority to add, remove, or amend regulations and/or professional standards. Specifically, BPC

5010 provides the CBA authority to adopt, repeal, or amend regulations. BPC 5018 provides the CBA authority to create regulations that prescribe, amend, or repeal rules of professional conduct. Additionally, the note references related BPC sections. Specifically, BPC 5018 provides the CBA authority to create regulations that prescribe, amend, or repeal rules of professional conduct. BPC 5027 provides the CBA authority to prescribe, amend, or repeal regulations specific to CE. BPC 5082 contains the requirement for applicants to pass a CBA-approved examination prior to licensure. BPC 5093 describes the requirements to obtain a CPA license.

3. **Section 87.1(a)** is amended to remove the language which reads: “All continuing education must be completed on or after the date the initial license was issued”. The language will be replaced with: “Once a license is issued, a licensee is required to complete a two-hour regulatory review course as described in Section 87.8 at any time between the date the initial license was issued and the first license expiration date. This continuing education shall be part of the total hours of continuing education required by this section but shall not be part of the continuing education required by subsection (c), (d), (e), (f) or (g)”.
- A. Purpose: The current language in subsection (a) is redundant with subsection (i), which reads: “All continuing education required by this section shall be completed in the two-year period immediately preceding the date on which the licensee applies for license renewal. If the date on which the licensee applies for license renewal is less than two years from the date the initial license was issued, all continuing education must be completed on or after the date the initial license was issued.” The substitution language adds a requirement that newly licensed CPAs must complete a Regulatory Review CE course prior to a CPA’s first expiration date.
- B. Rationale: This amendment is necessary to address the concern that California laws and regulations will not be sufficiently covered following the elimination of the PETH Exam as a licensure examination. Approximately 13% of the PETH Exam is related to California-specifics laws and regulations. The elimination of the PETH Exam may create a gap in knowledge for newly licensed CPAs if the California-specific information is not addressed shortly after licensure. Amending subsection (a) to remove the current language eliminates the need to change multiple subsections within section 87.1 to accommodate the newly proposed language that requires a regulatory review course to be completed prior to the first license expiration date. The current language in subsection (a) is duplicative of subsection (i) and may be removed entirely. The requirement to complete the Regulatory Review course prior to the first license expiration date ensures that newly licensed CPAs are not practicing for several years without the California-specific knowledge they would have gained from completing the PETH Exam.

4. **Section 87.1(b)** is amended to remove the language that reads: “no continuing education is required for license renewal”. The language will be replaced with: “the only continuing education required for license renewal is the two-hour regulatory review course described in subsection (a)”.
 - A. Purpose: The proposed amendment requires all newly licensed CPAs to complete the two-hour regulatory review course within their first renewal cycle regardless of the length of the renewal cycle. Prior to the proposed amendments, licensees were not required to complete any CE if the period of time between the date of license issuance and the date of first expiration was less than six months.
 - B. Rationale: Ensuring that all newly licensed CPAs complete the two-hour regulatory review course is necessary as a means to compensate for the removal of the PETH Exam. Additionally, the proposed amendment is necessary to further clarify when the two-hour regulatory review course is required to be completed.

Underlying Data:

Technical, theoretical, or empirical studies, reports, or documents relied upon:

1. Department of Consumer Affairs Licensure Examination Validation Policy (OPES-22-01)
2. November 16-17, 2023 CBA Meeting Agenda
3. November 16-17, 2023 CBA Meeting Agenda Item II.E.
4. Summary of OPES Review of the Professional Ethics Examination for Certified Public Accountants (PETH Examination)

Business Impact:

The CBA has made the initial determination that the proposed regulatory action would have no significant statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

This initial determination is based on the following facts/evidence/documents or testimony:

Currently, pre-licensure candidates are required to pass the PETH Exam, which is administered by CalCPA. Approximately 3,150 candidates pay \$175 to take the PETH Exam per year, which results in total annual costs to applicants of \$551,250.

Under this proposal, pre-licensure applicants will no longer be required to take the PETH Exam. Instead, once an applicant is licensed as a CPA, they will be required to complete a two-hour Regulatory Review CE course by their first license renewal. The average cost of a Regulatory Review CE course is \$50, resulting in total annual costs to applicants of \$157,500.

The elimination of the PETH Exam will result in a revenue loss to CalCPA in the amount of \$551,250 annually. However, the CBA notes, in the event an individual opts to enroll in the

two-hour Regulatory Review CE course offered by CalCPA, any lost revenues due to the elimination of the PETH Exam may be offset with CE course fees. However, the CBA does not have an estimate at this time.

To assist those who have purchased the PETH Exam and are not able to use it to meet their licensure requirements before the elimination, the CBA has proposed a two-year transition period to allow completion of the PETH Exam to count towards two hours of technical CE for their first license renewal.

The PETH Examination is a California-specific requirement and will not impact the ability of California businesses to compete with businesses in other states.

Economic Impact Assessment

This CBA has determined that this regulatory proposal will have the following effects:

- It will not create or eliminate jobs within the State of California because the proposed changes are not of sufficient magnitude to create or eliminate jobs or businesses. The proposal removes a pre-licensure examination requirement and replaces it with a post-licensure CE course, that must be completed at the licensee's first renewal. The proposal eliminates a pre-licensure requirement, and the post-licensure replacement course is less expensive, which would result in cost savings for the individual.
- It will not create new businesses or eliminate existing businesses within the State of California even though CalCPA will experience a revenue loss resulting from the elimination of the PETH Exam. Further, CalCPA is a CBA-approved provider for the Regulatory Review course, which will replace the PETH Exam and, it's possible, that licensees will choose to take the post-licensure CE course from CalCPA, offsetting some revenue loss.
- It may affect the expansion of businesses currently doing business within the State of California as a new CE course provider may apply to the CBA to become a CBA-approved Regulatory Review course provider.
- This regulatory proposal benefits the health and welfare of California residents because the proposed post licensure CE requirement – completion of the CBA-approved Regulatory Review course – covers the provisions of the California Accountancy Act and the California Board of Accountancy Regulations specific to the practice of public accountancy in California emphasizing the provisions applicable to current practice situations. The course also includes an overview of historic and recent disciplinary actions taken by the Board, highlighting the misconduct which led to licensees being disciplined.
- This regulatory proposal does not affect worker safety because it has nothing to

do with worker safety.

- This regulatory proposal does not affect the state's environment because it has nothing to do with the environment.

Specific Technologies or Equipment:

This regulation does not mandate the use of specific technologies or equipment.

Consideration of Alternatives:

No reasonable alternative to the regulatory proposal would be either more effective in carrying out the purpose for which the action is proposed or would be as effective or less burdensome to affected private persons and equally effective in achieving the purposes of the regulation in a manner that ensures full compliance with the law being implemented or made specific.

Set forth below are the alternatives which were considered and the reasons each alternative was rejected:

Alternative 1: Pre-licensure course: Require a pre-licensure course that covers California statutes and regulations not covered by the CPA Exam. The CBA-approved Regulatory Review CE course could be used instead of the current requirement for a licensure examination. While this would reduce overall costs involved to obtain a CPA license in California, it adds to the pre-licensure requirements at a time when the CPA profession is experiencing a reduction in the pipeline of future CPAs. California statutes and regulations are currently assessed on the PETH Exam by only six to seven questions; therefore, replacing the PETH Exam with a 2-hour pre-licensure, Regulatory Review CE course is not a viable option.

The proposed regulations have been determined to be the most efficient and effective means of implementing the law in the least burdensome manner.

Description of reasonable alternatives to the regulation that would lessen any adverse impact on small business:

No such alternatives have been proposed, however, the CBA welcomes comments from the public.