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COVID-19 & Ethics | Staff Publication

APPLYING THE CODE'S CONCEPTUAL FRAMEWORK IN COVID-19 CIRCUMSTANCES

Scenarios in Taxation and Valuation Services

July 2020

Applying the Code's Conceptual Framework in COVID-19 Circumstances to Scenarios in Taxation and Valuation Services

This staff publication provides guidance on the application of the conceptual framework in the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code) to four scenarios covering services or activities relating to taxation and valuation arising due to the circumstances of the pandemic. Two of the scenarios apply to professional accountants in public practice and the other two to professional accountants in business.

The scenarios are hypothetical and are solely intended to illustrate the application of the conceptual framework to enable accountants to identify, evaluate and address threats to compliance with the fundamental principles in the Code created by COVID-19 circumstances.

Professional accountants need to be mindful and take into consideration that some jurisdictions might have provisions that differ from or go beyond those set out in the Code. In these jurisdictions, accountants need to be aware of those differences and comply with the more stringent provisions unless prohibited by law or regulation.

This publication was developed by the Staff of the Australian Accounting Professional & Ethical Standards Board (APESB) under the auspices of a Working Group formed by the International Ethics Standards Board for Accountants (IESBA) and national ethics standard setters (NSS) from Australia, Canada, China, South Africa, the UK and the US.¹ The Working Group's charge is to develop implementation support resources to assist professional accountants in public practice and professional accountants in business in effectively applying the Code when facing circumstances created by the COVID-19 pandemic.

This publication does not amend or override the Code, the text of which alone is authoritative. Reading this publication is not a substitute for reading the Code. The implementation guidance is not meant to be exhaustive and reference to the Code itself should always be made. This publication does not constitute an authoritative or official pronouncement of APESB, the IESBA or the other NSS organizations that form part of the Working Group.

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1. The NSS are the Australian Accounting Professional & Ethical Standards Board, Chartered Professional Accountants Canada, the Chinese Institute of Certified Public Accountants, the South African Independent Regulatory Board for Auditors, the UK Financial Reporting Council, and the American Institute of Certified Public Accountants.

SCENARIO 1

Taxation Services — Professional Accountant in Public Practice

A professional accounting firm provides business, audit and tax compliance services to its clients which are predominantly small to medium-sized entities. The COVID-19 pandemic has negatively impacted a significant proportion of the firm's clients from a cashflow perspective.

The government has legislated support measures to help stimulate the economy and assist businesses to survive and recover from the effects of the pandemic. One such measure, which is administered by the taxation authority, provides businesses with a cash injection of \$100,000 where they can demonstrate that turnover has been reduced by 30% or more for the month of March 2020 compared to March 2019 due to the pandemic.

A major client of the firm has stated that it is eligible and requested one of the firm's tax partners to apply on its behalf to the taxation authority to obtain the cash injection. The firm provides business and tax compliance services, but not audit services, to this client and the annual fees earned from this client make up to 20% of the tax partner's fee base. Although the client has suffered from the impact of the pandemic, its turnover may or may not have been reduced by the required percentage and, therefore, the client's eligibility for the cash injection needs to be assessed. The tax partner will be reliant on turnover information and documentation provided by the client in making the relevant application to the taxation authority.



Identifying Threats

Self-interest

There is a threat arising from the tax partner's fear of losing the major client and the associated fees if the client does not receive the cash injection, which could inappropriately influence the tax partner's judgement or behaviour. This could threaten the fundamental principles of integrity, objectivity, professional competence and due care, and professional behaviour (para [120.6 A3\(a\)](#)).

Familiarity

There might be a threat that due to long or close relationships with the major client, the tax partner will be too sympathetic to the client's interests or too accepting of the information provided by the client to apply for the cash injection. This could threaten the fundamental principles of integrity, objectivity, professional competence and due care, and professional behaviour (para [120.6 A3\(d\)](#)).

Intimidation

There is a threat that the tax partner will be deterred from acting objectively due to actual or perceived pressures from the major client to ensure they receive the cash injection due to the financial pressures they are facing (para [120.6 A3\(e\)](#)).



Evaluating Threats

Are Identified Threats at an Acceptable Level?

The tax partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. Consideration of qualitative and quantitative factors is relevant in the evaluation of threats, as is the combined effect of multiple threats, if applicable (para [120.8 A1](#)).² Factors that may be relevant in evaluating the level of the threats include:

- ▶ Conditions, policies and procedures relating to the client and its operating environment and the firm and its operating environment (paras [300.7 A1](#) to [300.7 A5](#) list several factors that may be relevant).
- ▶ Understandability and clarity of the legislative measures to be eligible for the cash injection.
- ▶ The client being a major client of the tax partner (qualitative factor).
- ▶ The length and closeness of the relationships between the tax partner and the major client (qualitative factor).
- ▶ As the taxation authority is administering the cash injection and assessing applications this may reduce the threats (para [120.8 A2](#) and a qualitative factor).
- ▶ Whether the firm and/or the tax partner has also been significantly impacted by the pandemic, which may increase the incentive to retain the major client and maintain the fee base (quantitative factor).

Based on an assessment of these factors, a reasonable and informed third party might conclude that the threats to one or more of the fundamental principles are not at an acceptable level, and the threats would need to be addressed.



Addressing Threats

Eliminate Circumstances

The tax partner may not be able to eliminate the circumstances, including interests or relationships, that are creating the threats (para [R120.10\(a\)](#)).

Apply Safeguards

The tax partner must not knowingly be associated with reports, returns, communications or other information where the tax partner believes that the information contains a materially false or misleading statement (para [R111.2](#)). Therefore, if the tax partner determines that the major client does not meet the eligibility requirements of the cash injection, they must not make the application on behalf of the client. There are no safeguards available or capable of being applied to reduce the threats to an acceptable level.

In relation to the assessment of the eligibility criteria to meet the requirements to obtain the cash injection, in particular, if the turnover is at or just above the turnover reduction threshold, an example of a safeguard that might address the threats is (para [300.8 A2](#)):

- ▶ Having an appropriate reviewer who was not involved in providing the service review the service performed. For example, this could be another tax partner within the firm.

Decline or End Professional Activity

If the tax partner cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the tax partner may need to decline this service to the major client (para [R120.10\(c\)](#)).

2. Paragraph numbers in this publication refer to the IESBA Code.

SCENARIO 2

Taxation Services — Professional Accountant in Business

A medium-sized business with 100 employees has been forced to temporarily cease operations for six months due to government restrictions implemented because of the COVID-19 pandemic. The employees consist of full time, part-time and casual employees.

The business is suffering financially as a result of the closure and having difficulty meeting its financial obligations, including wages and loan and lease repayments.

The government has legislated support measures to help stimulate the economy and assist business survival and recovery. One such measure, which is administered by the taxation authority, is a temporary wage subsidy where eligible businesses can apply to receive \$1,500 per fortnight for each eligible employee, which is then to be passed on to the employees.

The CFO is preparing the application for the wage subsidy and has determined that a significant number of the employees are not eligible due to their casual status. The CEO strongly suggests that the CFO:

- a. change the status of the casual employees to part-time employees; and
- b. consider including the names of employees who have resigned from the business in the application,

as this would provide additional cash inflow to assist the business to survive and meet its other financial obligations.³



Identifying Threats

Self-interest

There is a threat that due to the CFO's fear of losing his or her job due to the business distress, such threat will inappropriately influence the CFO's judgement and behaviour. This could threaten the fundamental principles of integrity, objectivity, professional competence and due care and professional behaviour (para [120.6 A3\(a\)](#)).

Intimidation

There is a threat that the CFO will be deterred from acting with integrity and objectivity due to actual or perceived pressures from the CEO to ensure the business receives the wage subsidy in excess of what it is entitled to. If this occurs it will also be a breach of the laws and regulations (para [120.6 A3\(e\)](#)).



Evaluating Threats

Are Identified Threats at an Acceptable Level?

The CFO must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. At this stage it is a strong suggestion from the CEO and the act of including the ineligible employees has not occurred. Consideration of qualitative and quantitative factors is relevant in the evaluation of threats, as is the combined effect of multiple threats, if applicable (para [120.8 A1](#)). Factors that may be relevant in evaluating the level of the threats include:

- ▶ Conditions, policies and procedures relating to the work environment of the business (paras [200.7 A1](#) to [200.7 A4](#)), for example:
 - Leadership that stresses the importance of ethical behaviour and the expectation that employees will act ethically (also refer to para [270.3 A3](#)). The evaluation of threats would be heightened in this situation as the CEO is suggesting that the CFO should consider unethical behaviour.
 - Policies and procedures to empower and encourage employees to communicate ethics issues that concern them to senior levels of management without fear of retribution (also refer to para [270.3 A3](#) and human resources policies that address pressure). Even if such policies and procedures were in place in this scenario, they do not appear to have been adhered to by the CEO. The CFO could also consider accessing the professional ethics counselling service of the applicable professional body.

3. Under this scenario, an actual breach of laws and regulations has not yet occurred. Should there be actual or suspected non-compliance with laws and regulations (NOCLAR), the provisions in Section 260, *Responding to Non-compliance with Laws and Regulations* would also apply.

- ▶ The nature of the relationship between the CFO and the CEO, and the CFO and the ineligible casual employees (qualitative factors).
- ▶ As the taxation authority is administering the wage subsidy and assessing applications this may reduce the threats (para 120.8 A2 and a qualitative factor).
- ▶ Whether the business has cash or liquid resources or access to credit facilities to meet ongoing obligations such as loan and lease repayments (quantitative factor).

Based on an assessment of the factors a reasonable and informed third party would likely conclude that the threats to one or more of the fundamental principles are not at an acceptable level and the threats would need to be addressed.



Addressing Threats

Eliminate Circumstances

The CFO may not be able to eliminate the circumstances, including interests or relationships, that are creating the threats (para R120.10(a)).

Apply Safeguards

The CFO must not knowingly be associated with reports, returns, communications or other information where the CFO believes that the information contains a materially false or misleading statement (para R111.2). Therefore, if the CFO is aware that any of the employees are not eligible for the wage subsidy (including former employees of the business), they must not include these employees in the application to the tax authority. There are no safeguards available or capable of being applied to reduce the threats to an acceptable level.

The CFO must not allow pressure from the CEO to result in a breach of compliance with the fundamental principles (para R270.3(a)). Further, if the CEO is subject to the Code, they must not place pressure on to the CFO that they know, or have reason to believe, would result in the CFO breaching the fundamental principles (para R270.3(b)). However, if the CEO does exert pressure on the CFO, the CFO could take the following actions to ensure they do not breach the Code:

- ▶ Address the issue with the CEO and explain that including ineligible employees in the application would breach the Code and applicable law.
- ▶ If the CEO is unwilling to listen and continues to exert pressure on the CFO, the CFO could escalate the matter to those charged with governance and/or the chair of the audit committee.
- ▶ Document the processes they have followed to address the threats.

Even if the CFO does not allow pressure from the CEO to act unethically, the level of the threats might still not be at an acceptable level. In this situation, safeguards should be applied in relation to the application for the wage subsidy for the eligible employees. An example of a safeguard that might address the threats would be to have the business's external professional accountant/tax adviser who was not involved in preparing the application review the application before it is lodged with the taxation authority. Another option is to discuss the matter with the Board of Directors of the entity.

Decline or End Professional Activity

If the CFO cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the CFO may need to decline to prepare and lodge the application for the wage subsidy or resign from their position (para R120.10(c)). The CFO will also need to consider applicable legislative reporting obligations.

SCENARIO 3

Valuation Services — Professional Accountant in Public Practice

A partner at a professional accounting firm has been requested by a non-audit client which is selling one of its businesses to prepare an independent expert's report on the valuation of the business.

The business that is for sale has been financially impacted because of the COVID-19 pandemic, including reductions in revenue of approximately 25%. The partner is aware that the client's other financial endeavours have also been negatively affected by the pandemic and that the client is dependent on achieving as high a sale price as possible to alleviate financial pressures.

The partner is concerned that some of the underlying assumptions provided by the client for the valuation, especially in respect of revenue, may be overly optimistic in the current and post COVID-19 environment.



Identifying Threats

Advocacy

There is a threat that the partner will rely on optimistic assumptions to promote the client's business to the point that the partner's objectivity is compromised in a favourable valuation (para [120.6 A3\(c\)](#)).

Familiarity

There might be a threat that due to a long or close relationship with the client, the partner will be too sympathetic to the client's interests or too accepting of the client's assumptions. This could threaten the fundamental principles of integrity, objectivity, professional competence and due care, and professional behaviour (para [120.6 A3\(d\)](#)).

Intimidation

There is a threat that the partner will be deterred from acting objectively due to actual or perceived pressures from the client to ensure the valuation of the business is favourable to the client. There may also be internal pressures from other partners within the firm (para [120.6 A3\(e\)](#)).



Evaluating Threats

Are Identified Threats at an Acceptable Level?

The partner must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. Consideration of qualitative and quantitative factors is relevant in the evaluation of threats, as is the combined effect of multiple threats, if applicable (para [120.8 A1](#)). Factors that may be relevant in evaluating the level of the threats include:

- ▶ Conditions, policies and procedures relating to the client and its operating environment and the firm and its operating environment (paras [300.7 A1](#) to [300.7 A5](#) list several factors that may be relevant), including for example:
 - The client has competent employees with experience and authority to make managerial decisions. The higher the level of competence of the clients' employees, the lower the level of threats.
 - The ethical environment within the client.
 - Having leadership of the firm who promotes compliance with the fundamental principles would reduce the level of threats.
- ▶ The nature and the length of the relationship between the partner and the client (qualitative factor).
- ▶ The nature of the business and the level of complexity in the valuation and the underlying assumptions (qualitative and quantitative factors).

- ▶ The extent to which the partner or firm is involved in promoting the business to potential buyers.
- ▶ How aggressive the client is in terms of the assumptions underlying the valuation.
- ▶ The degree of urgency to which the client requires the valuation report.

Based on an assessment of the factors identified from the above considerations, a reasonable and informed third party might conclude that the threats to the expert's independence⁴ and one or more of the fundamental principles are not at an acceptable level and the threats would need to be addressed.



Addressing Threats

Eliminate Circumstances

The partner may not be able to eliminate the circumstances, including interests or relationships, that are creating the threats (para [R120.10\(a\)](#)).

Apply Safeguards

The partner must not knowingly be associated with reports, returns, communications or other information where the partner believes that the information contains a materially false or misleading statement (para [R111.2](#)). Therefore, if the partner is aware that any of the underlying assumptions are false or misleading, they must not rely on them in the independent expert's report. There are no safeguards available or capable of being applied to reduce the threats to an acceptable level.

If the partner is concerned about the integrity of the assumptions and relies on those assumptions, they may not be maintaining professional competence and due care and potentially be in breach of the Code ([Subsection 113](#)).

Even if the partner subsequently assesses the assumptions to be robust and appropriate, the level of the threats in undertaking the valuation might not be at an acceptable level. In this situation, safeguards should be applied in relation to the independent expert's report. An example of a safeguard that might address the threats would be to have an appropriate reviewer who was not involved in providing the service review the service performed (para [300.8 A2](#)). This may include another appropriately qualified partner from the firm.

Decline or End Professional Activity

If the partner cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the partner must decline to prepare the independent expert's report (para [R120.10\(c\)](#)).

4. In this scenario, laws, regulations or professional standards in the particular jurisdiction impose specific independence obligations on experts who perform these engagements.

SCENARIO 4

Valuation Services — Professional Accountant in Business

A private group of companies has been financially impacted because of the COVID-19 pandemic, including reductions in revenue over the previous six months of 40%. Recovery from the pandemic is expected to be slow for the group and may take up to two years before revenue returns to pre-pandemic levels.

As required by IAS 36, *Impairment of Assets* (IAS 36), the CFO is conducting annual testing of goodwill from the acquisition of a number of the parent company's subsidiaries for impairment. As required, the CFO assesses whether there is any indication of impairment after considering information, including significant changes with an adverse effect during the period or that will take place in the near future in the economic environment.

As there is an indication of impairment, the CFO is assessing the recoverable amount as required by IAS 36 as the higher of its fair value less costs of disposal and its value in use. Due to the current economic environment, the fair value is considerably lower than value in use. The CFO is, therefore, measuring the value in use under IAS 36, where cash flow projections are to be based on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset.

However, the CEO has made it clear that the CFO must minimise any impairment losses as any further write-downs for the group could have detrimental long-term effects for the group's viability.⁵



Identifying Threats

Self-interest

There is a threat that the CFO's fear of losing his or her job due to the economic distress caused by the pandemic will inappropriately influence their judgement or behaviour with respect to adopting the appropriate accounting treatment. This could threaten the fundamental principles of integrity, objectivity, professional competence and due care, and professional behaviour (para [120.6 A3\(a\)](#)).

Advocacy

There is a threat that the CFO will promote the group's financial viability to shareholders, lenders, creditors and other stakeholders to the point that the CFO's objectivity is compromised (para [120.6 A3\(c\)](#)).

Intimidation

There is a threat that the CFO will be deterred from acting objectively due to actual or perceived pressures from the CEO to ensure the group's financial statements demonstrate continued viability (para [120.6 A3\(e\)](#)).



Evaluating Threats

Are Identified Threats at an Acceptable Level?

The CFO must exercise professional judgement and apply the reasonable and informed third party test to determine whether the threats are at an acceptable level. Consideration of qualitative and quantitative factors is relevant in the evaluation of threats, as is the combined effect of multiple threats, if applicable (para [120.8 A1](#)). Factors that may be relevant in evaluating the level of the threats include:

- ▶ Conditions, policies and procedures relating to the work environment of the business (paras [200.7 A1](#) to [200.7 A4](#)), for example:
 - Leadership that stresses the importance of ethical behaviour and the expectation that employees will act in an ethical manner (also refer to para [270.3 A3](#)). The level of threats would be heightened in this situation as the CEO is suggesting the CFO minimise impairment losses, which might result in unethical behaviour.
 - Policies and procedures to empower and encourage employees to communicate ethics issues that concern them to senior levels of management without fear of retribution (also refer to para [270.3 A3](#) and human

5. Under this scenario, an actual breach of laws and regulations has not yet occurred. Should there be actual or suspected non-compliance with laws and regulations (NOCLAR), the provisions in Section 260, *Responding to Non-compliance with Laws and Regulations* would also apply.

resources policies that address pressure). Even if such policies and procedures were in place in this scenario, they do not appear to have been adhered to by the CEO.

- ▶ The nature of the relationship between the CFO and the CEO, for example, if the CEO is a forceful and domineering individual this would increase the level of threats (qualitative factor).
- ▶ The extent to which the outcome of the goodwill impairment exercise would affect the CFO's compensation or employment.
- ▶ The existence of an audit committee.
- ▶ The extent to which the CFO would need to justify the impairment assessment to lenders and other stakeholders.
- ▶ Other financial pressures on the business, for example, requirements to meet debt covenants (quantitative factor).

Based on an assessment of the factors identified from the above considerations and the CEO's position that the business cannot sustain further impairment losses, a reasonable and informed third party would likely conclude that the threats to the fundamental principles are not at an acceptable level and the threats would need to be addressed.



Addressing Threats

Eliminate Circumstances

The CFO may not be able to eliminate the circumstances, including interests or relationships, that are creating the threats (para R120.10(a)).

Apply Safeguards

The CFO must not knowingly be associated with reports, returns, communications or other information where the CFO believes that the information contains a materially false or misleading statement (para R111.2). Therefore, the CFO must not be associated with any impairment calculations that they are aware of that will be false or misleading. There are no safeguards available or capable of being applied to reduce the threats to an acceptable level.

The CFO must not allow pressure from the CEO to result in a breach of compliance with the fundamental principles (para R270.3(a)). Further, if the CEO is subject to the Code, they must not place pressure on to the CFO that they know, or have reason to believe, would result in the CFO breaching the fundamental principles (para R270.3(b)). However, if the CEO does exert pressure on the CFO, the CFO could take the following actions to ensure they do not breach the Code and IAS 36:

- ▶ Address the issue with the CEO and explain that incorrectly applying the impairment requirements would breach the Code and IAS 36.
- ▶ If the CEO is unwilling to listen and continues to exert pressure on the CFO, the CFO could escalate the matter to those charged with governance and/or the chair of the audit committee.
- ▶ Document the processes they have followed to address the threats.

Assuming the CFO does not allow pressure from the CEO to act unethically, the level of the threats might still not be at an acceptable level. In this situation, safeguards should be applied in relation to the impairment testing and calculations. An example of a safeguard that might address the threats would be to have the group's external professional accountant (but not the audit firm) who was not involved in undertaking the impairment testing review the work performed. Another option is to discuss the impairment testing and calculations with the Board of Directors.

Decline or End Professional Activity

If the CFO cannot eliminate the circumstances creating the threats and no safeguards are available or capable of being applied to reduce the threats to an acceptable level, the CFO may need to decline the activity or resign from their position (para R120.10(c)).

About APESB

Accounting Professional & Ethical Standards Board (APESB) was formed in 2006 as an independent national standards setter in Australia with the primary objective of developing professional and ethical standards in the public interest for the members of the three Australian Professional Accounting Bodies, namely Chartered Accountants Australia and New Zealand, CPA Australia and the Institute of Public Accountants. The three Professional Accounting Bodies are the members of APESB.

About IESBA

The International Ethics Standards Board for Accountants (IESBA) is an independent global standard-setting board. The IESBA's mission is to serve the public interest by setting ethics standards, including auditor independence requirements, which seek to raise the bar for ethical conduct and practice for all professional accountants through a robust, globally operable *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code).

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