

Ethics Potpourri

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Diversity and Inclusion

Diversity

- ▶ Very few Black CEOs, CFOs, controllers at large corporations and very few black partners at large accounting and law firms.
- ▶ 2010: 7 Black CEOs in Fortune 500
- ▶ 2020: 5 Black CEOs in Fortune 500
- ▶ Innovation revenue is 19% higher for companies with above average diversity in their management team.
- ▶ Greater diversity also leads to less cronyism and tends to result in more comprehensive systems for performance reviews.
- ▶ Greater diversity also benefits a business in the long run, attracts clients that are looking for diversity from their suppliers or service providers, and contributes to the local community.

How to Enhance Diversity

- ▶ Corporations and professional firms should work with business schools to enhance financial literacy components in curriculums and provide more accessible instruction in the basic financial and managerial accounting courses and the basic finance courses that are in the core curriculum and success in which are likely to lead students to select the more lucrative finance and accounting majors.
- ▶ Corporations and professional firms should encourage the founding of National Association of Black Accountant (or National Bar Association, or other similar organizations) chapters at local schools and encourage participation in those organizations by employees.

More Methods to Enhance Diversity

- ▶ Ensure diversity in the interns you hire and look at a greater range of university students.
- ▶ Try to find a way to hire diverse high school students for internships. This gives them something to put on their resume even earlier in their careers.
- ▶ Consider work experience outside of professional settings (i.e., work experience other than internships) when hiring entry level employees.
- ▶ Most importantly, set up formal and informal mentoring programs and make sure that every lower-level professional employee has a mentor.

Supportive Work Environment

- ▶ It is important to set up a rotation system or some other system where everyone in a meeting has a chance to speak. For example, going around the table. Even better, have the leader of a meeting call on people and start with the most junior professionals present.
- ▶ Recognize good ideas from everybody and objectively assess your recognition. There are countless stories of women, and especially black women, who suggest an idea at a meeting, the conversation moves on, and then a white man suggests the same idea later in the conversation. The white man is then recognized and called out publicly as the originator of a good idea.

12-Step Plan for Revamping or Starting Inclusion Initiatives

- ▶ This 12-step plan was suggested by the following article:

Kimberly Ellison-Taylor, CPA, CGMA, Together, we can make a difference: A 12-step plan to address racism and unconscious bias: A time of unrest has provided an opportunity for CPAs to make an impact in their workplaces and the community, Journal of Accountancy, August 1, 2020

1. Acknowledge the challenges faced by the Black and African American community
2. Conduct a “listen and understand” town hall with ideas crowdsourced from team members across the organization.
3. Review the data—initiatives around recruitment, promotions, and overall retention of Black and African American team members.

12-Step Program (Continued)

4. Ask periodically for honest feedback on the culture of the organization and communicate transparently about the results and action plan.
5. Establish appropriate funding that is aligned with outcomes expected.
6. Communicate the vision.
7. Encourage allies to join the affinity groups, and create new groups based on hobbies and interests.
8. Determine ways to promote individual and collective accountability for the inclusion culture and the organization's core values.

12-Step Program (Continued)

9. Journey-map the employee experience of various employees.
10. Conduct diversity and inclusion training.
11. Review what additional support and training can be provided to middle managers based on various scenarios and exit interviews.
12. Move inclusive leadership to the main stage.

Important Recent Study on The Glass Ceiling

- ▶ Cohen, Dalton, Holder-Webb, McMillan, An Analysis of Glass Ceiling Perceptions in the Accounting Profession, Journal of Business Ethics Volume 164 (2020)
- ▶ The authors tried to determine whether women perceived a glass-ceiling and what factors women perceived as contributing to a glass ceiling.
- ▶ For whether women perceived a glass ceiling, they found that most women did perceive a glass ceiling. The groups of women most likely to perceive a glass ceiling were single women, mothers, women from racial and ethnic minorities, and women who were not partners of public accounting firms or CFOs or Controllers in industry.

Glass Ceiling (Continued)

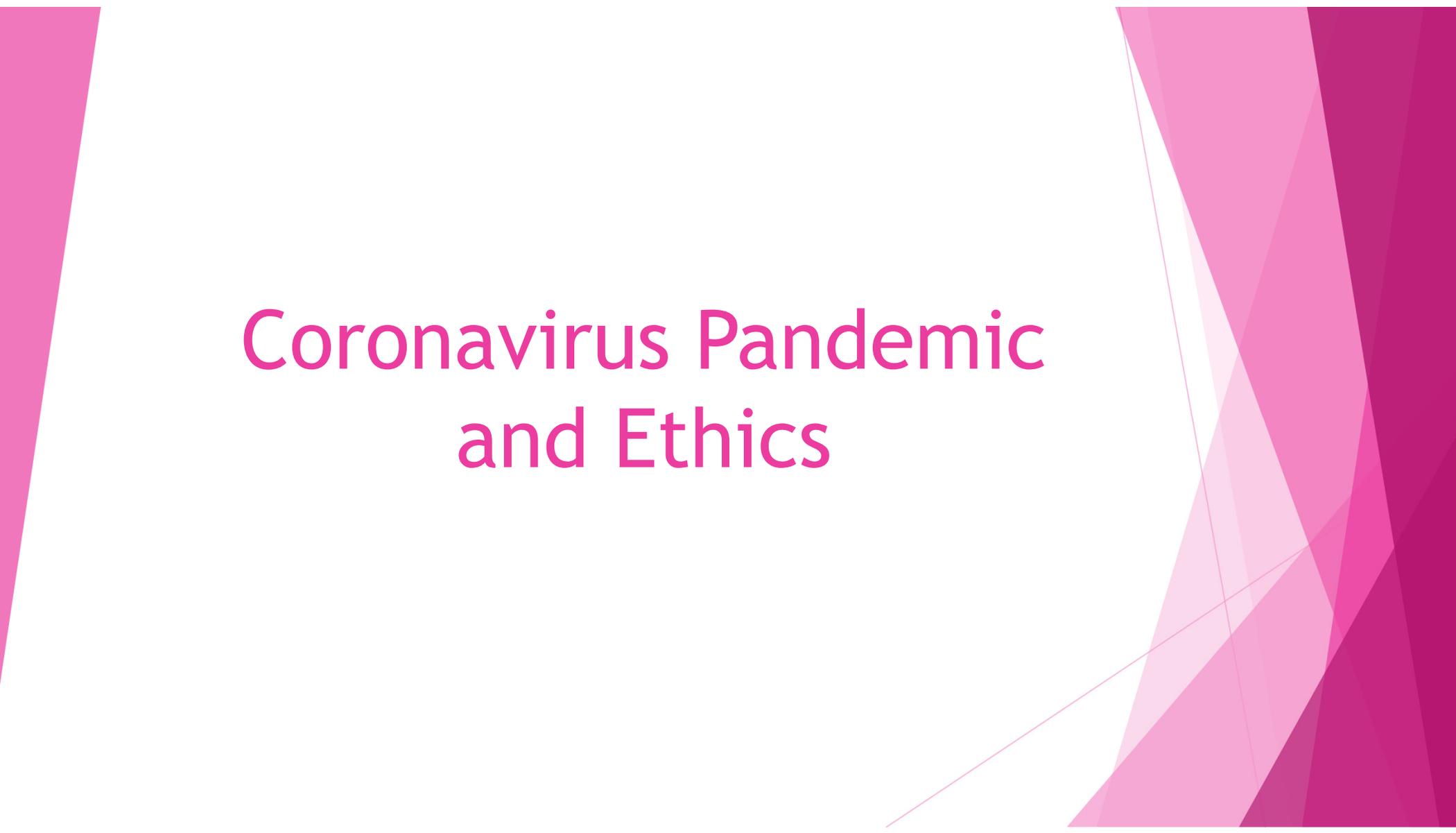
- ▶ More interesting was the investigation of what women perceived as the causes of the glass ceiling.
- ▶ The authors examined three types of effects:
 1. Bias-driven effects (perceived bias against promotion)
 2. Structural effects (lack of mentoring opportunities, networking opportunities, high profile job assignments)
 3. Cultural effects (lack of social support from male leaders)

Glass Ceiling (Continued)

- ▶ The authors found that structural effects were perceived as the most important reason for
- ▶ The perceptions as to which structural barriers were most significant were different at public accounting firms and in industry.
- ▶ In public accounting firms, lack of mentoring was perceived as the biggest barrier.
- ▶ In industry, all of lack of mentoring, lack of networking opportunities, and lack of high profile job assignments were perceived as barriers.

Glass Ceiling (Continued)

- ▶ The finding that structural barriers are the main barrier is actually good news because this is the easiest area for a firm to take action.
- ▶ High-quality formal mentoring programs that involve all lower and mid-level employees make for big improvements.
- ▶ Firms and companies should also ensure that all employees have access to and are encouraged to participate in networking events.
- ▶ A work rotation system should be implemented to ensure that all employees have equal access to high-profile assignments.



Coronavirus Pandemic and Ethics

General Background

- ▶ Coronavirus pandemic has shut lots of offices.
- ▶ Economic pressures may result in misconduct by those who would not otherwise commit crimes or break ethical rules.
- ▶ Some research has indicated that Americans are cheating more and feeling less guilty about it.
- ▶ Professor Sreedhari Desai: “It is only natural for housebound workers to experience a sense of isolation, stress, and anxiety. Based on my research, anxious people are more likely to cut corners, bend the rules, and make unethical decisions.”
- ▶ People who are feeling anxious focus inward and focus on acquiring resources (e.g., money) to mitigate anxiety.

Data Security and Intellectual Property

- ▶ Two major categories:
 - ▶ Purposeful or reckless acts
 - ▶ Negligent or inadvertent acts

Negligent Acts

- ▶ First, the negligent acts: this is obvious. You are more susceptible to data breaches if you have lots of employees working from home.
- ▶ Firms need to invest in VPN and other security measures (such as two-factor authentication). Some places started doing this before the pandemic. With the pandemic, everyone should be doing this.
- ▶ Security of mobile devices:
 - ▶ A lot of information is stored on mobile devices. Firms need to make sure that employees are instructed to limit what is stored on mobile devices.
 - ▶ Firms need to educate employees about mobile device security such as having a complex and hard to guess pin or password (don't use 123456 as your password for your cell phone).

Purposeful or Reckless Acts

- ▶ Intellectual property is vulnerable to theft.
- ▶ IT has a harder time monitoring remote workers on unsecured networks.
- ▶ Remember, as described above, workers are more anxious and are dealing with more mental health issues during the pandemic.
- ▶ These issues make workers more susceptible to temptations, such as taking pictures of product designs on their phone and then sharing them with others, either purposefully to engage in destructive behavior or just to show family and friends or to show off their knowledge.
- ▶ I had a personal experience with this a long time ago with a colleague sharing from a work computer while at work. Such behavior was easy to catch at work. Much harder from home.

Many Possible Motivations

- ▶ There are many possible temptations for ethical failings or loss of corporate loyalty during the pandemic.
- ▶ Many people feel like they are “victims” right now.
- ▶ Loss of job security (especially if colleagues have been laid off), stressful work environment (kids learning from home or multiple generations living together for support), not feeling watched and thus feeling freer to misbehave.
- ▶ All of these may lead to misuse of work product, disclosure of confidential client information, or breach of non-disclosure agreements.

Day Trading

- ▶ Day trading has greatly increased during the pandemic.
- ▶ Day trading poses all sorts of risks for regulated professions such as accounting or law.
- ▶ Inadvertent tripping of insider trading laws
- ▶ Creating conflicts of interest by improperly buying, selling, or holding stocks without disclosure.

Leadership Stress

- ▶ Leadership stress causes decisionmakers to nudge
- ▶ Likely sources of leadership stress are uncertainty, time pressure, short-term horizons, and isolation. Many of these are exacerbated by the pandemic.

Curbing Dishonesty

- ▶ Standard approach relies on enforcement and deterrence: increase punishments and patrol more so that people think they might be caught.
- ▶ However, this does not increase honesty, it just encourages people to become better cheaters. They do more acts of small cheating (harder to detect). Very few people do big cheating.

Research on Curbing Dishonesty

- ▶ Source: Ayal, Gino, Barkan, and Ariely, Three Principles to REVISE People's Unethical Behavior,
- ▶ This is some of the most interesting research and has broad applications for public policy, fraud deterrence, professional ethics, business ethics, and corporate social responsibility.
- ▶ Three Principle Framework
 1. Reminding
 2. Visibility
 3. Self-Engagement

Reminding

- ▶ Emphasizes the effectiveness of subtle cues that increase the salience of morality and decrease the ability to justify dishonesty.
- ▶ People take advantage of grey areas to justify dishonest behavior.
- ▶ Laboratory experiment on cheating. One group told they're monitored. Other group told they can shred the results. The second group inflated results.
- ▶ Second group was asked to recall the 10 Commandments before the task. Cheating disappeared.
- ▶ Moral reminders before tasks work. Identify victims or uses of money. For taxes, remind people that tax dollars go to essential services that they rely on. "Your tax dollars at work."

Visibility

- ▶ People who feel like they are being watched are more likely to behave ethically.
- ▶ Even a picture of eyes makes people feel like they are being watched.

Self-Engagement

- ▶ Car mileage study.
- ▶ People were asked to sign at the top of the page (before they entered car mileage and other information about the car) or at the bottom of the page (after entering information) a typical statement that the information that they entered was true.
- ▶ People who signed at the top of the page entered higher mileage numbers.
- ▶ This should encourage honor code signing and other sorts of signing on a regular basis that one will proceed honestly even before beginning an assignment. This can accompany more typical signatures that are required that the information presented is true.
- ▶ Integrity bracelets and lapel buttons are also useful.

AICPA, IESBA, and IAASB

“Using Specialists in the COVID-19 Environment”

- ▶ The International Ethics Standards Board for Accountants (IESBA), the International Auditing and Assurance Standards Board, and the American Institute of Certified Public Accountants formed a working group along with national ethics standard setters from Australia, Canada, China, South Africa, the UK, and the US. The working group issued its report “Using Specialists in the COVID-19 Environment” in October 2020.
- ▶ The working group is designed to assist accountants in addressing unique issues arising under ethical codes during the novel coronavirus pandemic.

Using Specialists

- ▶ The coronavirus pandemic might require new uses of specialists.
- ▶ For example, accounting firms may need to use economists to understand the business environment and economic outlook that serves as a general background for an audit. In the in-house context, economists may help with strategies for dealing with financial uncertainty.
- ▶ Accounting firms and businesses may need to hire more information technology specialists and may need to hire fraud specialists to deal with the threats to security and possibilities for fraud created by employees primarily working from home.
- ▶ Generalist accounting firms and auditors may need a tax specialist to determine the implications of participation in various government assistance programs, including loan forgiveness, subsidies, and grants.

Auditor Reports

- ▶ The use of a specialist to assist an auditor in preparing a report may require that the area where the specialist worked is disclosed as a key audit matter and the use of the specialist discussed in regard to that matter.

Coronavirus Pandemic and Stress

- ▶ Let's look at these websites and discuss:

CDC:

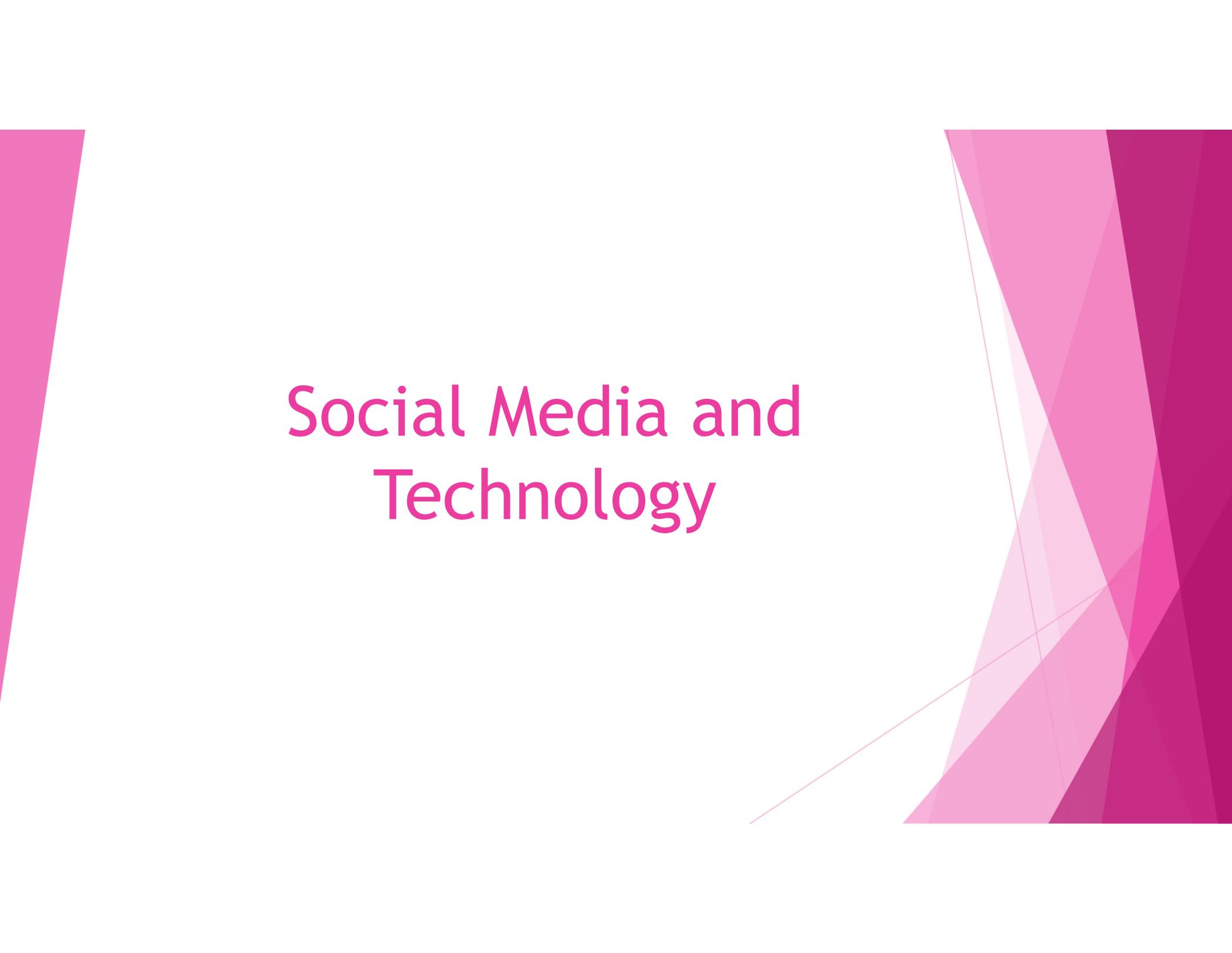
<https://www.cdc.gov/coronavirus/2019-ncov/community/mental-health-non-healthcare.html>

More CDC:

<https://www.cdc.gov/coronavirus/2019-ncov/daily-life-coping/managing-stress-anxiety.html>

Understood.org:

<https://www.understood.org/en/workplace/coronavirus-resources/pandemic-stress-employee-support>



Social Media and Technology

Video Content on Social Media

- ▶ Be careful of posting video content with actors
- ▶ Last year, IRS Office of Professional Responsibility reprimanded a practitioner for posting videos that portrayed IRS agents in a negative light and suggested techniques that would delay orderly tax collection.

Metadata

- ▶ You must be very careful with your metadata.
- ▶ There was a case last year in front of the IRS Office of Professional Responsibility where a firm put the names of prominent CPAs and attorneys in its metadata so that search engines would be more likely to find the firm. None of these CPAs or attorneys worked at the firm. This is a big no-no! You are responsible for overseeing your website even though you don't write the metadata. You have an obligation to put in place quality control measures that prevent programmers from being too cute.
- ▶ Another time when you have to be careful with metadata is when you share files, you must make sure that the metadata does not disclose confidential information to third parties that are not intended recipients of that information.
- ▶ There are also times when metadata might weaken a negotiating position or embarrass an individual.

Advertising

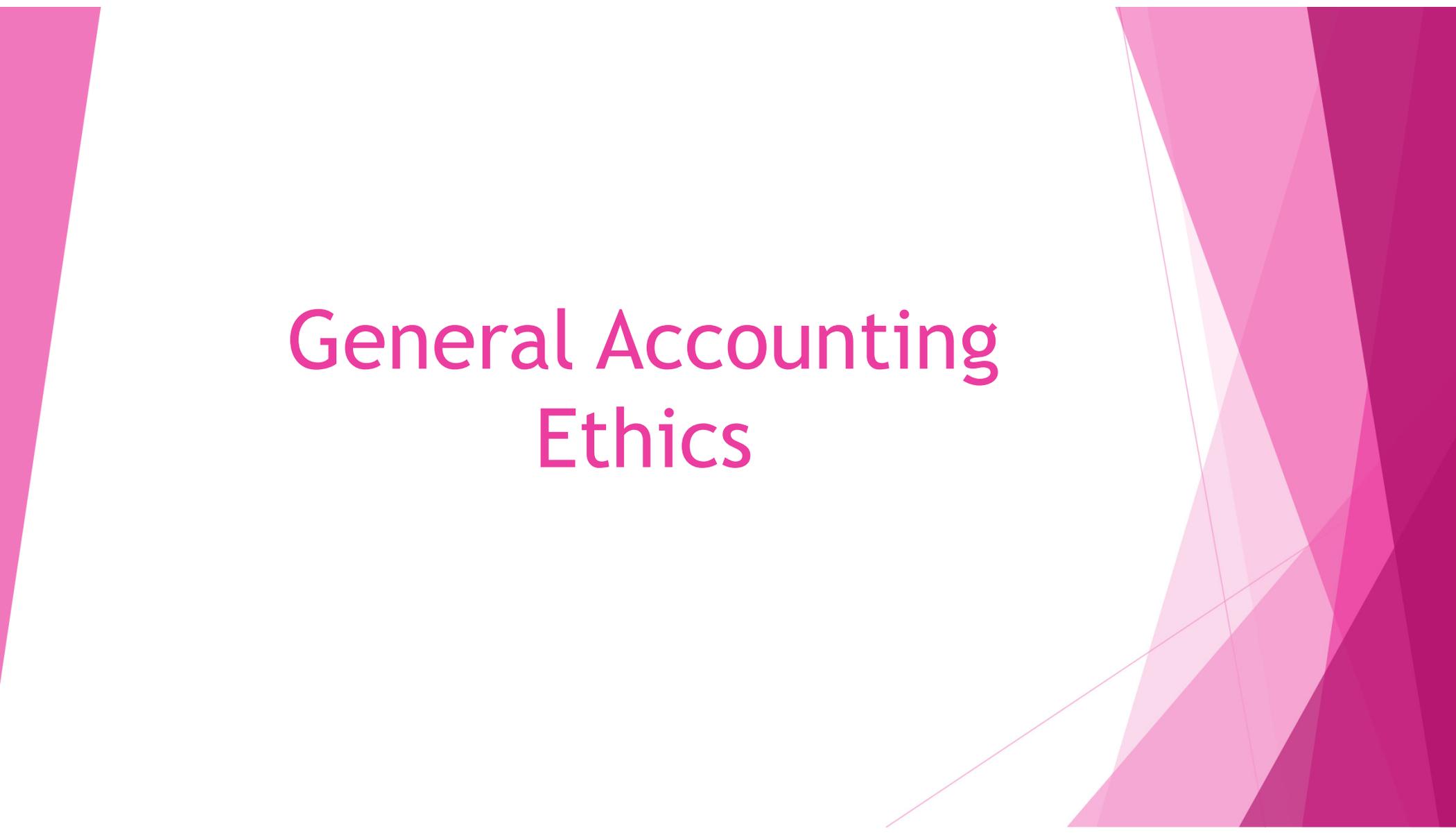
- ▶ Firms with multiple CPAs and/or attorneys must be constantly vigilant with online advertising.
- ▶ If you have an advertisement running on Facebook, LinkedIn, or another website, and it features specific individuals, you must be very vigilant.
- ▶ If one of those individuals leaves the firm or biographical data about one of those individuals changes, you must immediately change all online advertising on all platforms that features that individual. Last year, the IRS Office of Professional Responsibility found a firm in violation of Circular 230 for failure to promptly remove such advertising.

Cloud Storage

- ▶ Use of cloud data storage must be carefully monitored.
- ▶ If you use a cloud data storage company, you have the same obligations to oversee their performance as you have with respect to an individual employee.
- ▶ This means that you must ensure that the cloud storage company has comprehensive data privacy and data security policies and practices that protect against the inadvertent disclosure of taxpayer information. Otherwise, you may violate Circular 230.

Advertising on LinkedIn and Similar Sites

- ▶ Key things here are endorsements and skills
- ▶ You need to make sure that you do not advertise any skills that you do not have
- ▶ You need to make sure that you do not make exaggerated and sweeping claims such “master of all things X” (where X is a giant field such as tax, law, accounting, auditing, etc.).
- ▶ You need to reject (or not show) endorsements from people who barely know you or endorsements for skills that you cannot reasonably claim to possess.



General Accounting Ethics

Responding to Client Record Requests

- ▶ AICPA Code is broader than Circular 230. Circular 230 only requires Client Prepared or Third Party Prepared Records to be returned upon request.
- ▶ AICPA Code also requires Member Prepared records to be provided. This includes adjusting, closing, combining, or consolidating journal entries (including computations supporting such entries) and supporting schedules and documents that the member proposed or prepared as part of an engagement.
- ▶ AICPA says members may withhold member work papers that are not member-prepared records and all kinds of records for which fees have not been paid.
- ▶ How long you have to turn over depends on state—AICPA: 45 days; PICPA: 45 days; Texas State Board: 10 days (“promptly”).

Non-Disclosure Agreements

- ▶ Recent discussions in the accounting literature have noted that CPA firms are increasingly being asked to sign non-disclosure agreements (NDAs).
- ▶ There are several problematic types of non-disclosure agreements.
 - ▶ Prohibiting disclosure of information to third-party advisers. At the very least, a CPA firm should be able to consult with its own attorneys regarding the terms of the NDA and any issues in an engagement.
 - ▶ Prohibiting disclosure of information to employees or owners of the CPA firm not involved in the engagement. This should be covered in the engagement letter and must be carefully negotiated and should only be agreed to if the engagement would seem to require it.
 - ▶ Restricted ownership and third-party access rights to proprietary information, such as occurs in the development of computer software. Parties necessary to complete the engagement should be identified and exempted.
 - ▶ Permitting assignment by the other party of their rights under the NDA. Such assignment should not be permitted or should be carefully limited.

Recent Cases Involving Audit and Nonaudit Services

- ▶ Recent article: Steven M. Mintz, Now Is the Time to Operationally Split Audit and Nonaudit Services, The CPA Journal, October/November 2020

Abstract: Performing certain nonaudit services for audit clients can impair independence. Misrepresenting nonaudit services as immaterial and mischaracterizing them as audit services obscures the conflicts of interest that may occur when both services are performed for an audit client. In the United Kingdom, regulators are moving towards separating audit businesses operationally. The SEC should study the issue to determine how to implement a similar split in the United States. Nothing short of this remedy is sufficient to protect the public interest.

- ▶ Although you may not agree with Mintz's argument in the last part; it's worth noting that at least some are arguing for this and the ethical issues he raises in the article are worth contemplating.

Examples of Audit and Nonaudit Service Violations

- ▶ September 23, 2019: PwC agreed to pay \$7.9 million to settle charges that the firm violated Rule 2-02 by performing prohibited nonaudit services during an audit engagement, including exercising decision-making authority in the design and implementation of software relating to an audit client's financial reporting, and engaging in management functions.
- ▶ The firm's actions created a self-review threat to independence. In addition, the firm violated PCAOB Rule 3525 in connection with performing nonaudit services for 15 SEC-registered audit clients by failing to describe in writing to the audit committee the scope of work, to discuss the potential effects of work on independence, and to document the substance of the independence discussion.

Examples (Continued)

- ▶ The violations occurred due to breakdowns in PwC's independence-related quality controls, which resulted in the firm's failure to properly review and monitor whether nonaudit services for audit clients were permissible and approved by a client's audit committee.

Another Example

RSM

- ▶ August 27, 2019: SEC charged RSM US LLP with violating Rule 2-02(b)(1) in connection with more than 100 audit reports involving at least 15 audit clients.
- ▶ RSM repeatedly represented that it was independent in audit reports issued on the clients' financial statements even though it provided prohibited nonaudit services to, and had an employment relationship with, affiliates of RSM US audit clients.
- ▶ The prohibited nonaudit services included corporate secretarial services, payment facilitation, payroll outsourcing, loaned staff, financial information system design or implementation, bookkeeping, internal audit outsourcing, and investment advisory services.

RSM Example (Continued)

- ▶ The SEC also cited a deficiency in independence controls at the firm that led to its failure to identify and avoid these prohibited nonaudit services.
- ▶ The violation created a self-review threat to independence and created the appearance that the firm could not be objective in providing audit services.

Important Point from Examples

- ▶ The PwC and RSM examples demonstrate the possible negative outcomes when audit firms either ignore or misinterpret restrictions on performing nonaudit services for audit clients that are set forth in SEC Rule 2-02 as well as Rule 1.295.040 of the AICPA Code.
- ▶ Most of these restrictions are directly or indirectly prohibited under SOX and SEC Rule 2-01, which mirrors SOX restrictions.

Materiality

- ▶ Don't assume that you can provide services because of materiality.
- ▶ KPMG was taking on a new audit client.
- ▶ KPMG learned that the firm had been providing nonaudit services to affiliates of the soon to be client which KPMG would be prohibited from providing as independent auditor.
- ▶ These services included bookkeeping and payroll services provided to affiliates in 11 different countries.
- ▶ KPMG audit engagement team consulted internal Independence Group and they concluded that based on the “perceived immateriality of the locations and services provided, KPMG’s overall independence would not be impaired if it became the auditor of the entity but also continued providing the nonaudit services to the affiliates during the transition period of February 22, 2008 to July 1, 2008.

Materiality (Continued)

- ▶ KPMG became the auditor and confirmed to the client that it was “independent with respect to the client and its related entities under applicable SEC and PCAOB independence requirements.”
- ▶ The firm’s actions violated SEC Rules 201(c)(5) and 10A-2.
- ▶ Takeaway: firms must be very careful to follow all applicable ethical rules, including applicable state laws, accounting codes of ethics, SEC regulations, and PCAOB standards.

SEC Amendments to Auditor Independence Rules

- ▶ October 20, 2020: SEC announced changes to Rule 2-01 of Regulation S-X that loosen independence rules with respect to auditing of affiliates and investment company clients.
- ▶ New rule limits range of audit client affiliates from which an auditor must maintain its independence by:
 1. Amending the definition of “affiliate of the audit client” to carve out affiliates under common control (i.e., sister entities) that are not material to the controlling entity and
 2. Providing, with respect to the audit of an investment company, investment advisor, or sponsor, that the auditor and audit client would look solely to the definition of “investment company complex” to identify audit client affiliates under common control that are not material to the controlling entity.

New SEC Rules (Continued)

- ▶ The rule gives auditors more discretion in assessing conflicts of interest in affiliate relationships
- ▶ Mintz criticizes SEC for moving away from independence as “cornerstone of audit engagements” and instead “relying on objectivity and impartiality.”
- ▶ UK is moving in other direction and requiring Big 4 to operationally separate their audit practices. UK is considering prohibiting all nonaudit services for audit clients.

AICPA View on New Rules

- ▶ The AICPA submitted a comment letter when the SEC proposed the new rule.
- ▶ The AICPA had a generally favorable attitude toward the changes proposed by the SEC.
- ▶ The AICPA supported the materiality requirement with respect to nonaudit services for sister entities and even wanted to extend it to the entity under audit.
- ▶ The AICPA pointed out that the IESBA also uses a similar materiality standard in its code.

Other Changes to the Rules made by the new SEC Rule

- ▶ The amendments to Rule 2-01 of Regulation S-X:
 - ▶ Address affiliate relationships and entities under common control to better define them for purposes of SEC rules.
 - ▶ Shorten the lookback period for domestic first-time filers in assessing compliance with the independence requirements.
 - ▶ Exclude certain student loans and de minimis consumer loans from independence-impairing lending relationships.
 - ▶ Changed the term in Rule 2-01(c)(3) from “substantial stockholders” to the concept of beneficial owners with significant influence.
 - ▶ Replace the transition provision in Rule 2-01(e) with a new Rule 2-01(e) to introduce a transition framework to address inadvertent independence violations that only arise as a result of merger or acquisition transactions.

Split Vote

- ▶ Two of the five SEC Commissioners opposed the Rule change.
- ▶ Allison Herren Lee and Caroline A. Crenshaw said that: “Among other changes, today’s rules replace a clear standard with one that provides auditors greater discretion when assessing their own independence and presents greater risk of mistaken or inconsistent application of that stanrd. What’s more, under the final rules, there is no mechanism for ensuring that the SEC and the investing public have visibility into how effectively auditors are making these assessments. And, as has too often been the case in recent years, these changes are disfavored by investors—those who actually rely on auditor assurances.”

Joint Staff Guidance on Specialists in COVID-19 Environment

- ▶ AICPA, International Ethics Standards Board for Accountants, and International Auditing and Assurance Standards Board jointly issued guidance on using specialists during the COVID-19 pandemic.

Staff CPE

- ▶ Make personal CPE plans for each staff member.
- ▶ CPE plans emerge from the review process.
- ▶ CPE plans can both play to strengths and address weaknesses.
- ▶ For example, a tax team member might be very strong in technical skills but be lacking in interpersonal skills.
- ▶ Thus, a tax CPE might be selected to broaden their background and such a person might even be encouraged to present at a conference in an area where they are an expert.
- ▶ Thus, a CPE that addresses soft skills in business might be suggested.
- ▶ CPEs should not just be chosen for cost.

Moral Turpitude

Source: Steven Mintz, Fundamental Principles of “Professional Behavior”:
Strengthening Professionalism by Enhancing Moral Conduct, The CPA Journal,
March 2020

- AICPA Code has “Acts Discreditable” section
- This section covers things like negligence in preparation of financial statements or records, failing to turn over requested records to clients, and certain personal failings such as failure to file a tax return.
- However, unlike International Ethical Standards Board for Accountants (IESBA) and unlike most (maybe all) bars in the US, there is no general provision regarding acts of “moral turpitude.”

Moral Turpitude (Continued)

- ▶ AICPA is committed to having standards that at least meet the minimum standards of IESBA.
- ▶ AICPA Professional Ethics Executive Committee proposed an amendment to the AICPA Code that would require members to take certain actions when they learn about noncompliance with laws and regulations.
- ▶ Ultimately, this provision was not adopted although the NASBA is allowed to act on NOCLAR disclosures without client consent.
- ▶ Mintz argues that the NOCLAR principle should be adopted.

State Board Discipline

- ▶ State Boards of Accountancy as a matter of practice often discipline for acts that would constitute acts of moral turpitude. They simply don't call them that. Although, Texas does use the term "moral turpitude."
- ▶ Poor judgment in personal decisions are a major category, often called "social crimes": driving under the influence, nonpayment of child support, drug possession.
- ▶ Financial crimes such as money laundering, drug dealing, and immigration fraud.

Other Personal Behavior

- ▶ Sexual Harassment
- ▶ Gender and Age Discrimination
- ▶ Improperly close friendships with CFOs of audit clients.

Changing The AICPA Code

- ▶ Mintz suggests that the Code could be changed to provide further fleshing out of the Acts Discreditable provision and to provide examples as discussed above.

Frequently Asked Questions: Nonattest Services (Jan. 31, 2020)

- ▶ For routine activities, a member is not required to apply safeguards. Routine activities are incidental and are insignificant in terms of time incurred or resources expended. This includes answering occasional tax questions, providing advice on routine business matters, educating the client on issues within the technical expertise of the member, and providing information about best practices.

Frequently Asked Questions: Nonattest Services (Jan. 31, 2020)

- ▶ Tax compliance services (such as return preparation) performed for an attest client are nonattest services. The documentation requirement applies.
- ▶ For bookkeeping services, a designated individual from the attest client, preferably within senior management, must review and approve any proposed journal entries.
- ▶ Controllorship services impair independence. Having the title of Controller impairs independence.

Frequently Asked Questions: Nonattest Services (Jan. 31, 2020)

- ▶ Tax planning services (just like tax compliance services) are subject to the requirement that the member and the client document in writing the understanding with respect to the services.
- ▶ Preparation of the personal tax returns of the owners of a business are not nonattest services as long as representations of the attest client are not required to complete the return.
- ▶ A member firm may provide services to an attest client related to application of ASC 740, such as identifying potential uncertain tax positions, advising the attest client whether those tax positions meet the more-likely-than-not threshold, and calculating unrecognized tax benefits as long as the individual designated by the attest client can make an informed judgment on the results of the member's services and the other requirements of the "General Requirements for Performing Nonattest Services" interpretation are met.

Recent AICPA Proposal on Loaning Staff

- ▶ AICPA Professional Ethics Executive Committee recently proposed an addition to the AICPA Code that would make it almost impossible for firms providing attest services to loan personnel to clients. In rare cases where permissible, numerous safeguards would be required.

Sustainability Development

- ▶ International Federation of Accountants (IFAC) is calling for the creation of a new sustainability accounting standards board that would exist alongside the International Accounting Standards Board (IASB) under the IFRS Foundation.
- ▶ Investors, policymakers, and regulators are demanding a reporting system that will deliver consistent, comparable, reliable, and assurable information relevant to enterprise value creation, sustainable development, and evolving stakeholder expectations.
- ▶ The World Economic Forum (Davos) released a set of universal environmental, social, and governance (ESG) measures and disclosures that is designed to help companies report nonfinancial disclosures.

Benefit Corporations and Certified Benefit Corporations

- ▶ Explore this website link below and we will discuss:

<https://bcorporation.net/>



Legal Ethics

ABA Formal Opinion 489 (Dec. 4, 2019) Obligations Related to Notice When Lawyers Change Firms

- ▶ Lawyers have right to leave a firm and practice at another firm
- ▶ Clients have the right to switch lawyers or law firms.
- ▶ Departing Lawyer must provide sufficient notice of intended departure for the firm and departing lawyer to notify clients.
- ▶ Firms cannot punish clients by withholding resources where the client decides that they would like the departing lawyer to continue to represent them.
- ▶ Departing lawyers have pre- and post-departure cooperation obligations to make sure that files are updated, remaining firm lawyers are updated on developments, and that billing is correct and fair.

ABA Formal Opinion 489 (Continued)

- ▶ Lawyers need not wait to inform clients of impending departure as long as firm is informed contemporaneously.
- ▶ Law firm management and other lawyers at the firm may also contact clients.
- ▶ Preferred next step is to send joint communications to clients requesting that clients elect who will continue representing them.
- ▶ Departing Lawyers should communicate with all clients with whom they have had significant client contact.

ABA Formal Opinion 489 (Continued)

- ▶ Clients determine who will represent them.
- ▶ Lawyers and law firms may not divide up clients when lawyers leave or a firm dissolves.
- ▶ During the period from notice to departure, firms should not displace lawyers who had principle or material responsibility for a matter.

ABA Formal Opinion 489 (Continued)

- ▶ Firm should not offer to continue to represent client if departing lawyer is only lawyer at firm with necessary expertise.
- ▶ Departing attorneys must return or delete all client confidential information in their possession unless the client is coming with them.

ABA Formal Opinion 489 (Continued)

- ▶ Reasonable notice periods have to be flexible. Firms cannot require a certain number of days for all departing lawyers in all cases.
- ▶ This is especially true if all files are up to date and other lawyers have been involved so that they can easily be briefed on matters that remain.

ABA Formal Opinion 489 (Continued)

- ▶ Firms must provide normal access to all firm resources during the time when a lawyer is leaving the firm. This includes other lawyers or associates, email, files, etc.
- ▶ Firms and departing lawyers should determine how new matters and new clients will be handled during the transition period.

ABA Formal Opinion 491 (Apr. 29, 2020)

- ▶ This Formal Opinion is on the duty to inquire so as to avoid counseling or assisting in a crime or fraud in a non-litigation setting.
- ▶ This is a particularly important area for tax lawyers (and this information is also useful for other tax professionals (e.g., CPAs and EAs) because the ethical codes of those professions deal with similar issues in similar contexts.
- ▶ Even if a lawyer does not have knowledge from an initial meeting with a potential client, there may be a further duty to inquire based on the duties of competence, diligence, communication and honesty under Rules 1.1, 1.3, 1.4, 1.13, 1.16, and 8.4.

ABA Formal Opinion 491 (Apr. 29, 2020)

- ▶ Two example situations:
 1. Client might seek legal assistance for a series of purchases and sales of properties. This may mean that the client is attempting to launder money.
 2. Client might propose an all-cash deal in large amounts and ask that the proceeds be deposited in a bank located in a jurisdiction where transactions of this kind are commonly used to conceal terrorist financing or other illegal activities.
- ▶ Ascertaining whether a client seeks to use the lawyer's services for prohibited ends is a delicate task. Generally, clients are entitled to be believed. However, the client benefits from honest advice from an attorney.

ABA Formal Opinion 491 (Apr. 29, 2020)

- ▶ Duty to Inquire under Rule 1.2(d)
- ▶ Rule 1.2(d): a lawyer “shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent.”
- ▶ Know includes actual knowledge. However, facts that on their face show impropriety (even if not illegality) are construed as actual knowledge.
- ▶ If the facts show high probability, Rule 1.0(f) declares that actual “knowledge may be inferred from circumstances.” Thus, a lawyer cannot ignore the obvious.
- ▶ ABA Informal Opinion 1470 declared that lawyers may not ignore facts that even suggest that the representation may aid a client in a crime or a fraud.

ABA Formal Opinion 491 (Apr. 29, 2020)

- ▶ Indiana State Bar Association: Attorney violated ethical obligations by creating a “new” sole power of attorney for a prospective client on behalf of her wealthy grandfather in matters concerning his estate.
- ▶ Granddaughter could fraudulently use power of attorney to benefit herself rather than serve interests of grandfather.
- ▶ Attorney had not consulted grandfather.
- ▶ Grandfather might lack capacity to consent (lawyer’s paralegal had observed grandfather’s deteriorated health condition).

ABA Formal Opinion 491 (Apr. 29, 2020)

- ▶ New York City Ethics Opinion 2018-4: Lawyers must inquire when “retained to assist an individual in a transaction that appears to the lawyer to be suspicious.”
- ▶ “In general, assisting in a suspicious transaction is not competent where a reasonable lawyer prompted by serious doubts would have refrained from providing assistance or would have investigated to allay suspicions before rendering or continuing to render legal assistance.... What constitutes a suspicion sufficient to trigger inquiry will depend on the circumstances.”
- ▶ Lawyer cannot avoid the relevance of facts that are readily available.
- ▶ Other courts hold that lawyers are not allowed to “deliberately evade” knowledge which may implicate them in a fraudulent scheme.

ABA Formal Opinion 491 (Apr. 29, 2020)

- ▶ Criminal law has a doctrine of willful blindness.
- ▶ A lawyer may face criminal charges or civil liability, in addition to bar discipline, for deliberately or consciously avoiding knowledge that a client is or may be using the lawyer's services to further a crime or fraud.
- ▶ Duty of further inquiry.

ABA Formal Opinion 491 (Apr. 29, 2020)

- ▶ Facts and Circumstances to consider when determining whether there is a further duty to inquire:
 1. Identity of the client
 2. Lawyer's familiarity with the client
 3. Nature of the matter (sort of matter that may be associated with criminal or fraudulent activity)
 4. Relevant jurisdictions (any of them high risk?)
 5. Likelihood and gravity of harm associated with proposed activity
 6. Nature and depth of lawyer's expertise in relevant area of practice
 7. Other facts regarding trustworthiness of client
 8. Other facts related to competent representation

ABA Formal Opinion 491 (Apr. 29, 2020)

- ▶ Duties of competence, diligence, and communication under Rules 1.1, 1.3, and 1.4 may require the lawyer to develop knowledge of the facts and the law to understand the client's objectives, identify means to meet the client's lawful interests, to probe further, and, if necessary, persuade the client not to pursue criminal or fraudulent courses of conduct.
- ▶ Among the facts and law that a lawyer must ascertain are limits on the lawyer's own conduct.
- ▶ Rule 1.13(a) imposes a duty to inquire in entity representation. The lawyer needs to ascertain the interests of the entity, which may be different than the interests of the lawyer's contact at the entity.

ABA Formal Opinion 491 (Apr. 29, 2020)

- ▶ If a lawyer needs information from someone other than the client, the lawyer should obtain it if doing so does not require disclosing confidential or otherwise protected information.
- ▶ If confidential/protected information would need to be disclosed in the course of an inquiry to a third party, the lawyer should obtain the client's permission to contact the third party.
- ▶ If the client refuses to allow the lawyer to seek information from a third party or if the lawyer thinks that seeking consent will lead to criminal or fraudulent activity, the lawyer is required to withdraw or decline representation.

ABA Formal Opinion 491 (Apr. 29, 2020)

- ▶ If the client or third party provides information that indicates that further representation would involve the lawyer in participating in a crime or a fraud, the lawyer should remonstrate the client and suggest that the client not embark on a course of action that would result in a crime or a fraud.
- ▶ The lawyer should not assume that the client will not be responsive to remonstration.
- ▶ However, if the client insists on embarking on a criminal or fraudulent course of action, the lawyer must decline the representation or withdraw.
- ▶ In some cases, the lawyer may choose not to remonstrate the client and simply decline the representation or withdraw.

ABA Formal Opinion 492 (June 9, 2020)

- ▶ A lawyer is prohibited from accepting a new matter if the lawyer received information from a prospective client that could be significantly harmful to the prior prospective client in the new matter that the lawyer is considering accepting.
- ▶ Determining whether information is significantly harmful is based on all of the facts and circumstance, including the length of the consultation and the nature of topics discussed.
- ▶ Even if a lawyer did learn such information, other lawyers at the firm can accept and work on the matter as long as the lawyer is screened from the new matter or the previous prospective client provides informed consent.

ABA Formal Opinion 492 (June 9, 2020)

- ▶ Lawyers are obligated not to disclose confidential information of prospective clients except as permitted to disclose with respect to a former client.
- ▶ The key is “could be significantly harmful” and such information relates to essential or important matters in a case such as settlement terms or eyewitness accounts of important acts that are the subject of litigation.
- ▶ Lawyers should limit initial consultation so as to minimize the likelihood of receiving such information.

ABA Formal Opinion 493 (July 15, 2020)

- ▶ In August 2016, the ABA House of Delegates adopted Model Rule 8.4(g). The Rule prohibits a lawyer from “engag[ing] in conduct that the lawyer knows or reasonably should know is harassment or discrimination on the basis of race, sex, religion, national origin, ethnicity, disability, age, sexual orientation, gender identity, marital status or socioeconomic status in conduct related to the practice of law.”
- ▶ “As one court emphasized in sanctioning a male lawyer for disparagingly referring to his female adversary as “babe” and making derogatory, sexual comments during a deposition:

[The lawyer’s] behavior...was a crass attempt to gain an unfair advantage through the use of demeaning language, a blatant example of ‘sexual [deposition] tactics.’ These actions...have no place in our system of justice and when attorneys engage in such actions they do not merely reflect on their own lack of professionalism but they disgrace the entire legal profession and the system of justice that provides a stage for such oppressive actors.

ABA Formal Opinion 494 (July 29, 2020)

- ▶ Conflicts Arising Out of a Lawyer's Personal Relationship with Opposing Counsel
- ▶ Intimate relationships need to be disclosed and consent sought from both parties. In some cases, it may not be possible to proceed with representation
- ▶ Lawyers need to consider whether opposing counsel would have too easy of access to confidential information.
- ▶ For friendships, disclosure will usually be required and consent may be required if the friendship is close enough. Factors to consider: Close mentoring relationship. Lots of social contact. Multi-generational contact between families. Vacationing together.



Hypotheticals on Legal Ethics

From ABA Formal Opinion 491

Five Hypotheticals

#1: A prospective client has significant business connections and interests abroad. The client has received substantial payments from sources other than his employer. The client holds these funds outside the US and wants to bring them into the US through a transaction that minimizes US tax liability. The client says:

- (i) He is “employed” outside the US but will not say how
- (ii) The money is in a “foreign bank” in the name of a foreign corporation but the client will not identify the bank or the corporation
- (iii) He has not disclosed the payments to his employer or any governmental authority or to anyone else; and
- (iv) He has not included the amounts in his US income tax returns.

ABA Formal Opinion 492 (June 9, 2020)

#2: A prospective client tells a lawyer he is an agent for a minister or other government official from a “high risk” jurisdiction who wishes to remain anonymous and would like to purchase an expensive property in the United States. The property would be owned through corporations that have undisclosed beneficial owners. The prospective client says that large amounts of money will be involved in the purchase but is vague about the source of the funds, or the funds appear to come from “questionable” sources.

ABA Formal Opinion 492 (June 9, 2020)

- ▶ #3: A general practitioner in rural North Dakota receives a call from a long-term client asking her to form a limited liability company for the purpose of buying a ranch.

ABA Formal Opinion 492 (June 9, 2020)

#4: The general practitioner in rural North Dakota receives a call from a new and unknown prospective client saying that the client just won several million dollars in Las Vegas and needs the lawyer to form a limited liability company to buy a ranch.

ABA Formal Opinion 492 (June 9, 2020)

#5: A prospective client in New York City asks a general practitioner in a mid-size town in rural Georgia to provide legal services for the acquisition of several farms in rural Georgia. The prospective client tells the lawyer that he has made a lot of money in hedge funds and now wants to diversify his investments by purchasing these farms but says he doesn't want his purchases to cause a wave of land speculation and artificially inflate local prices. He wants to wire money into the law firm's trust account over time for the purchases. He asks the lawyer to create a series of LLCs to make strategic (and apparently unrelated) acquisitions.



Tax Ethics

Interventions to Improve Ethics

- ▶ Source: Fatemi, Hasseldine, and Hite, The Influence of Ethical Codes of Conduct on Professionalism in Tax Practice.
- ▶ Both tax practitioners and auditors are bound by common ethical codes. Those codes emphasize integrity and, in various situations, also emphasize advocacy on behalf of the client.
- ▶ Tax practitioners are serving their clients while at the same time are seen as having a duty to the tax system.

Interventions (Continued)

- ▶ This paper found that when presented with a specific ethical principle and then asked about advising on a hypothetical situation, those who were given presentations that stressed only integrity or those who were given presentations that discussed integrity first and then advocacy second were more likely to recommend more conservative positions.

Busy Season Debrief

Source: Brandon Lagarde and Brent Forbush, Prepare for Next Tax Season by Looking in the Rearview Mirror, *The Tax Adviser*, pages 202-204, March 2020.

Consider using leadership coaches, team building professionals, or mediators to facilitate a best practices conversation.

Make sure to solicit feedback from younger members of the team.

Focus on individual performance, changes, improvements, and areas for further improvement.

Conflicts of Interest

- ▶ In March 2020 the AICPA updated its Guidelines for Conflicts of Interest in the Performance of Federal Tax Services
- ▶ When practicing in the tax area, CPAs must consider both the AICPA Code and Circular 230.
- ▶ To determine a conflict of interest practitioners should evaluate whether:
 - ▶ One client's interests are directly adverse to another client's interests
 - ▶ There is a significant risk that the services to a client would be materially limited by the responsibility to provide services to another client, another person, or by the interests of the practitioner or the practitioner's firm
 - ▶ A client or other appropriate party could consider the practitioner's objectivity impaired because of the client relationships that each holds with the member or the member's firm

Conflicts of Interest

- ▶ Source: Anna Seto and Joseph Tapajna (Roby Sawyers, ed.), Tax Practice Responsibilities: AICPA Committee Updates its Conflict-of-Interest Advice, 51 The Tax Adviser 338-340 (May 2020)
- ▶ Every firm should have a conflicts process in place and should consider both the interests of current and former clients and the personal interests of (conflicts) of other employees at the firm.
- ▶ This is similar for both law and accounting firms. Note the similarity to regarding personal conflicts.
- ▶ Should identify conflicts in advance and either decline the engagement or obtain waivers/consents from all relevant parties.

Types of Conflicts

- ▶ Transactional conflicts: May arise when two or more existing clients want to do business with each other. You may not be able to represent both sides.
- ▶ Relational conflicts: Spouses going through a divorce. You may not be able to prepare separate returns for the both of them.
- ▶ Adversarial conflicts: IRS asserts liability against spouses for joint return (especially against now divorced spouses or spouses now going through a divorce) and one of them has an innocent spouse defense. Note: Innocent spouse defenses are actually hard to win.
- ▶ Conflicts with former clients: Conflict because of duty of confidentiality to former clients.
- ▶ Conflict with practitioner's own interests: If an IRS examination calls into question the practitioner's competence with respect to a return the practitioner previously prepared, the practitioner must withdraw.

Resolving a Conflict of Interest

- ▶ Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing professional services related to a particular matter for two or more clients whose interests with respect to that matter are in conflict. This could include:
 - ▶ Using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality;
 - ▶ Creating separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing of confidential client information from one practice area to another within a firm
 - ▶ Establishing policies and procedures to limit access to client files, the use of confidentiality agreements signed by employees and partners and the physical and electronic separation of confidential information.

Resolving Conflicts (Continued)

- ▶ Regularly reviewing the application of safeguards by a senior individual not involved with the client engagements.
- ▶ Having a member of the firm who is not involved in providing the service or otherwise affected by the conflict, review work performed to assess whether key judgments and conclusions are appropriate.
- ▶ Consulting with third parties, such as a professional body, legal counsel, or another CPA.