

Meeting: IESBA CAG
Meeting Location: Marriott, Prague, Czech Republic
Meeting Date: September 14, 2011

Conflicts of Interest

Objectives

1. To consider the IESBA's direction on its conflicts of interest project.

Background to Project

All professional accountants may face conflicts of interest. Section 220 of the Code addresses conflicts of interest for professional accountants in public practice. Section 310 of the Code addresses potential conflicts for professional accountants in business. The objective of this project is to revise Sections 220 and 310 to provide additional guidance for professional accountants in identifying and addressing conflicts of interest.

At its June 2011 meeting, the IESBA discussed Task Force¹ proposals and reviewed the wording for revisions to the Code for Sections 220 and 310 and paragraphs 100.17 and 100.18 (Agenda Item D-1). The Task Force plans to present a revised document to the IESBA for further discussion at its October 2011 meeting and request the document be exposed for comments.

The Task Force has met twice since receiving input at the June 2011 IESBA meeting and has held one conference call. This paper contains views of the Task Force that have not been presented to the Board.

Overview of Approach Taken

The IESBA is proposing to expand the guidance in Section 220 and provide new guidance for Section 310 concerning conflicts of interest. The IESBA is also proposing a new subsection of Section 100 titled "Conflicts of Interest" with two new paragraphs, 100.17 and 100.18, that describe conflicts of interest that may create threats to compliance with the fundamental principles. Overall, Sections 220 and 310 will be revised to provide the following guidance:

¹ Michael Niehues (chair), Nina Barakzai, Jim Gaa, Peter Hughes, Bob Rutherford, Sylvie Soulier, and Sandrine Van Bellinghen

- A description of a conflict of interest;
- Examples of situations in which conflicts of interest may arise;
- Factors to consider in identifying and evaluating potential conflicts of interest; and
- Safeguards that may be effective in addressing threats arising from conflicts of interest.

Description of a Conflict of Interest

A description of a conflict of interest will be included in paragraphs 100.17, 220.1 and 310.1. While there are many different types of situations that may be viewed as a “conflict of interest,” the proposed description specifically addresses the types of “conflicts” that will be addressed within each section. The description includes conflicts between:

1. The interests of two or more parties for whom the professional accountant undertakes professional activities; and
2. The interests of the professional accountant and the interests of a party for whom the professional accountant undertakes a professional activity.

Matters Specific to Section 220 of the Code

In addition to the guidance noted above, Section 220 of the Code will also address the following issues:

- It will require that the professional accountant take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude that compliance with the fundamental principles is compromised. This is required both when identifying and evaluating conflicts of interest and implementing safeguards.
- It will require that the professional accountant evaluate potential conflicts of interest when there is a reason to believe that one may exist due to the relationships within networks of firms. This issue is discussed further in this agenda paper.
- It will address situations where a firm may hold confidential information received from one client which could potentially damage that client’s interests if disclosed to another client of the firm and the requirements that must be met when accepting an engagement where such information might be relevant to the engagement and consent cannot be obtained. This issue is discussed further in this agenda paper.

Matters Specific to Section 310 of the Code

The material included in Section 310 of the extant Code is generally covered in other sections of the Code, and does not specifically address conflicts of interest as identified in the proposed description of a conflict of interest. Therefore, the current wording of Section 310 was removed entirely and provisions concerning conflicts of interest as described above were added to provide guidance for identifying, evaluating and managing conflicts of interest.

Section 310 will require the professional accountant in business to be alert to all interests and relationships that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, might give rise to a conflict of interest.

Description of a Conflict of Interest

At the June 2011 meeting of the IESBA, the Board considered the following general description of a conflict of interest:

“A professional accountant may be faced with a conflict of interest when undertaking a professional activity. A conflict of interest creates a threat to objectivity and may create threats to other fundamental principles. Such threats may be created by:

- *Conflicts between the interests of two or more parties for whom the professional accountant undertakes professional activities; or*
- *Conflicts between the interests of the professional accountant and the interests of a party for whom the professional accountant undertakes a professional activity.”*

At the Board meeting, the Task Force received feedback that the description should contain language stating that a conflict of interest may be such that a professional accountant is “unable to discharge his professional obligations effectively and in accordance with the fundamental principles in the Code.” The Task Force considered the feedback and drafted an additional sentence to be included in the description of a conflict of interest after the bullet points in Sections 220 and 310:

“A professional accountant shall not allow a conflict of interest to compromise professional or business judgment.”

In the Task Force’s view this addition to the description is responsive to the point made at the Board meeting without and is preferable to the wording proposed at the IESBA meeting. A professional accountant applies the guidance in sections 220 and 310, as appropriate, to determine whether a conflict of interest is such that he is unable to discharge his professional obligations. This conclusion is stated in paragraph 220.8 which requires the accountant to decline to perform or discontinue professional services that could result in the conflict of interests when safeguards cannot address the threat. The Task Force is of the view that the first paragraph of the section should focus on the description of a conflict of interest and it would be premature to include the statement that some conflicts may be such that the accountant would be unable to discharge his professional obligations. Accordingly, the Task Force plans to present this addition to the IESBA at the October 2011 meeting.

Action requested:

The CAG is asked to consider whether the additional sentence following the description of a conflict of interest adequately addresses the issue previously raised by the CAG.

Network Firms

At the June 2011 meeting of the IESBA, the Board considered the following proposed requirement in Section 220 with respect to conflicts of interest within a network of firms. The proposed text states that in identifying whether a conflict of interest exists and in evaluating any threat to objectivity or compliance with other fundamental principles, the professional accountant shall:

Evaluate any potential conflicts of interest that the professional accountant has reason to believe may exist due to interests and relationships of a network firm . .

Some members of the Board have suggested that the “reason to believe threshold” was too low. The Task Force considered stating that the professional accountant shall evaluate conflicts of interest when the professional accountant “knows or could reasonably be expected to know” that a conflict of interest may exist within a network of firms. The Task Force concluded that the “expected to know” threshold could create a need for new systems to enable network firms to know about relationships that other network firms have that create a conflict of interest. Whether such information can be shared across networks without violating local laws, regulations, or professional standards in various jurisdictions is unclear.

The “reason to believe” test by contrast requires consideration of the facts available to the professional accountant at that time without the added complexity of potentially having to develop new systems and without the operational limitations due to possible legal and regulatory implications governing the sharing of such information across networks. It is also consistent with paragraph 291.3 of the Code, which addresses identifying and evaluating threats to independence for network firms while performing assurance engagements other than audits and reviews. The Task Force agreed to the “reason to believe threshold” in the evaluation of conflicts of interest within a network of firms. Most of the Board also believe that the threshold is appropriate but requested that more guidance be provided by including examples of factors that the professional accountant should consider when evaluating whether a conflict of interest may exist between firms in a network.

Based on the Board’s feedback, the Task Force agreed to add additional language to the guidance on identifying whether a conflict of interest exists by including non-inclusive list of factors in that paragraph a statement that a professional accountant in public practice should consider whether there is reason to believe that a conflict of interest may exist within a network of firms taking into account factors such as the structure of the network, the geographic location of its firm, and the nature of the clients served. The

following language is to be recommended for inclusion in the bullet points of paragraph 220.5, which addresses identification and evaluation of conflicts of interest:

Evaluate any potential conflicts of interest that the professional accountant has reason to believe may exist due to interests and relationships of a network firm, taking into account factors such as the structure of the network, the geographic location of its firms and the nature of the clients served.

Action requested:

The CAG is asked to comment on the adequacy and appropriateness of the additional guidance contained in the sentence above concerning the evaluation of conflicts of interests between firms in a network.

Confidentiality

The Board has agreed to include guidance within Section 220 that addresses situations where, in the course of performing a professional service, a professional accountant in public practice may receive confidential information from a client that could potentially damage that client's interests if disclosed to another client of the firm. The guidance recognizes that, although it would generally be necessary in such situations to seek the consent of the client for whom confidential information is held, there are situations when this might not be practicable, but where nevertheless it is in the public interest for the professional accountant's firm to be able to accept or continue with the engagement. The purpose of the guidance is to establish certain conditions that are required to be met if consent is not to be obtained in such a situation.

The draft of the guidance can be seen in Agenda Item D-1, paragraph 220.10. This has been significantly amended since the draft presented to the IESBA in June. In particular, three conditions have been developed, based on the feedback from the Board in June.

The Task Force considered including an example of such a situation within the proposed Section 220 in order to add clarity to the guidance. The example is as follows:

For example, a firm might have two clients, one of which (the offeror) proposes to launch a takeover bid for the other (the offeree) where local regulation requires the offeror to obtain from the firm certain accounting reports with respect to the takeover bid. If the firm holds confidential information in respect of the offeree that could be relevant to the engagement for the offeror, consent of the offeree would normally be required as to the arrangements to maintain the confidentiality of the information, but the firm might not be authorized to seek such consent where the offeror's intentions cannot be disclosed to the offeree. In some cases, however, it may be impossible (for example due to time constraints) for another firm to undertake the engagement for the offeror, thus preventing the offeror from proceeding with its takeover plan.

The Task Force agreed that the example may be considered too detailed and specific for inclusion in the Code. Thus, the Task Force proposes to recommend that the example be included in the explanatory memorandum when presenting the matter to the Board at the October 2011 meeting.

Action requested:

The CAG is asked to comment on whether it is appropriate for the guidance to enable the accountant to proceed under the conditions prescribed.

Do CAG member believe the example should be included in Section 220 or only within the explanatory memo.

Sections 320 and 340 of the Code

Professional accountants in business may encounter certain ethical conflicts, such as undue pressure and self interest threats when preparing financial information and an arrangement exists whereby compensation is linked to the results of financial reporting. The Board agreed that these conflicts were not part of the scope of the conflicts of interest project and noted that they are addressed in Sections 320, *Preparation and Reporting of Information*, and 340, *Financial Interests*, of the Code. However, because those sections address a form of conflict that can threaten compliance with the fundamental principles, the Board requested that the Task Force consider whether the changes to Sections 220 and 310 have implications for Sections 320 and 340 and therefore similar changes should be made to those sections, or whether the Board should seek to add a new project to its project list to reconsider these sections.

After the June IESBA meeting, Sections 320 and 340 were modified to reflect certain conforming changes and serve as a working tool to assist the Task Force in considering the Board's request. For example, proposed paragraph 310.3 calls for the accountant to be alert to all interests and relationships that might give rise to a conflict of interest. A conforming change to Section 340 would include a similar directive, calling for the accountant to be alert to the principle of integrity and the obligation to be honest and straightforward in the face of, for example, pressure from a superior "to manipulate price sensitive information in order to gain financially" (see current paragraph 340.1).

There are different views as to whether a project should be sought to undertake a more extensive reconsideration and rewrite of the sections. The redrafts of the sections that are being considered by the Task Force are included with the agenda papers. They illustrate the types of changes being considered. Some members of the Task Force believe it is appropriate to make these changes within the scope of the conflicts of interest project, in particular to recognize similar threats to compliance with the fundamental principles that may be created by compensation and incentive schemes, such as threats to integrity, objectivity, and professional competence for professional accountants in

business. Other Task Force members question whether these changes would be sufficient and whether the relevant sections of the Code need to be rewritten, acknowledging that such a task is beyond the scope of the conflicts project.

The Task Force intends to make a considered recommendation on the way forward, which may include options, at the October IESBA meeting. The Task Force is agreed, however, that whereas it may be desirable to take the opportunity to make amendments to Sections 320 and 340 at this time, the primary concern is to proceed to finalise the proposals for Sections 220 and 310 of the Code, which fall within the core remit of the conflicts of interest project.

Action requested:

The Task Force would welcome feedback from the CAG on whether to proceed with the changes made to Sections 320 and 340 or defer such changes in favor of a broad reconsideration of those sections.

Material Presented

Agenda Item D	This Agenda Paper
Agenda Item D-1	Paragraphs 100.17-.18 and Sections 220 and 310
Agenda Item D-2	Illustrative Revised Sections 320 and 340
Agenda Item D-3	Feedback Statement on March 2011 CAG Comments