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**Agenda Item  
4**

**Committee:** International Ethics Standards Board for Accountants  
**Meeting Location:** Singapore  
**Meeting Date:** November 2-3, 2010

### **Conflicts of Interest**

#### **Objectives of Agenda Item**

1. To present the Task Force's update of the description of a Conflict of Interest (COI).
2. To discuss the Task Force's review of Sections 310, 200 and 100.17 through 100.22 of the Code.
3. To address the Board's input to the Task Force from the June 23-24, 2010 IESBA meeting in Paris

#### **Introduction**

The Task Force presented an update at the June 23-24, 2010 meeting of the IESBA in Paris. Since the Board meeting, the Task Force has met once on September 27-28, 2010. Based on the feedback from the Board and as directed in the Project Proposal, the Task Force has reviewed Sections 310, 220 and paragraphs 100.17 through 100.22 of the Code in order to, as the Project Proposal states "...provide up-to-date guidance for professional accountants in public practice and in business to identify and address conflicts of interest."

The Task Force has also revisited the definition of a COI proposed at the June 2010 Board meeting and made modifications based on comments provided by the Board.

#### **Definition of a COI**

The Task Force has considered the feedback provided by the Board at its Paris meeting. At that meeting proposed definition of a COI was:

"A conflict of interest arises if, when performing a professional service for a party the professional accountant has an interest or relationship other than with that party that threatens the accountant's ability to perform the service free of bias and undue restriction or influence."

The Task Force has considered the scope of the definition and, consequently the remit of the Task Force. In discussing this matter, the Task Force recognized that a COI can be

defined in a very broad way. The Task Force considered the totality of “self-interest conflicts of interest.” For example, at the June Board meeting, it was noted that a professional accountant in business may be pressured to meet certain targets by managers, and this would create a COI. The Task Force noted that many such conflicts of self-interest are already addressed in the Code. For example, the specific matter raised at the June meeting is addressed in paragraph 320.4 which states:

“Threats to compliance with the fundamental principles, for example, self-interest or intimidation threats to objectivity or professional competence and due, are created where a professional accountant in business is pressured (either externally or by the possibility of personal gain) to become associated with misleading information or to become associated with misleading information through the actions of others.”

The Code does not adequately address COIs created by external parties for example, a situation where a professional in public practice has a client and the accountant has an interest in a company that is a competitor of the client.

#### *Professional Services*

At the June IESBA meeting, the Task Force presented the above description of a COI to the Board noting that the provision of professional service is necessary to create a COI. The term “professional services” is defined in the Code as follows:

“Professional services – Services requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services.”

As noted in the minutes of the June 2010 meeting, feedback from the Board included the following comments:

- It needs to be very clear what is covered by the term “professional services”;
- While the term “professional services” is defined in the Code and includes professional accountants in practice and professional accountants in business, it is not a term that resonates with professional accountants in business. Such individuals would think of themselves as involved in business decisions as opposed to providing professional services; and
- It is not clear whether the term “professional services” would include the activities a professional accountant undertakes when serving on a board.

The Task Force noted that while the definition addresses all of the services performed, by professional accountants in public practice and in business the term does not clearly encompass service provided to an employer. For a professional accountant in business “professional services” would more likely be viewed as services that are purchased from third parties. Also, Part C of the Code applies to professional accountants in firms in their capacity as employees of the firm. The Task Force felt that it was unlikely that such an accountant would consider themselves to be providing professional services to their employing organization.

The Task Force believes that this is a matter which should be clarified and considered three options:

1. Continue to use the term “professional services” and propose changes to the definition;
2. Propose a new term, or two new terms to describe the tasks of professional accountants;
3. Continue to use the term “professional services” and add a footnote with additional information.

The Task Force concluded that the lack of clarity lay with the term “professional services” and therefore recommends the term “professional activities” be used to describe the tasks performed by all professional accountants. The Task Force recommends that “professional services” be adopted as a subset of these tasks that are performed by professional accountants in practice for clients. The two new definitions would be as follows:

*Professional Activities:* Activities requiring accountancy or related skills undertaken by a professional accountant including accounting, auditing, taxation, management consulting and financial management.

*Professional Services:* Professional activities performed for clients.

The definition for “professional activities” is similar to the current definition for “professional services” with the following changes.

- The term “activities” should resonate and be referable to all professional accountants.
- The term “undertaken” is used as opposed to “performed” in order to connect with “activities” as opposed to “services.”
- All of the same examples of activities from the definition remain the same in the newly proposed term in order to have a broad inclusion of accounting activities represented. However, the term “services” was removed after the word “management” in order not to create confusion with the term “professional services.”

The Task Force is of the view that the proposed change would not only assist in clarifying the description of a COI, but throughout Parts A and C of the Code, the term “professional activities” could be used in place of professional services. The Task Force believes the revisions will be better understood by users of the Code and the public.

**Action requested:**

The Board’s feedback is requested concerning the proposed changes in the terminology.

*Linkage to the Fundamental Principles*

At the June 2010 Board meeting in Paris, the Task Force presented its proposed description noting the linkage to the fundamental principle of objectivity. As noted in the minutes, the Board provided the following feedback:

- While the linkage to objectivity is the strongest, links to other fundamental principles may exist.
- The linkage between the definition of a conflict of interest should be to all of the fundamental principles of the Code. This approach would be holistic in nature.
- Confidentiality should be reconsidered for inclusion in the definition.

Based on these comments, the Task Force has reconsidered the linkage to the fundamental principles. During the discussions, arguments were made for all fundamental principles and it was noted that a link to objectivity alone may be too narrow. When serving two interests, there is a threat to the professional accountant's:

- Integrity in that the professional accountant must remain straightforward and honest to both (or all) parties involved;
- Objectivity in that the professional accountant must perform professional services for the two conflicting or competing interests free of bias;
- Professional competence and due care - Ability to perform services for the two parties with due care by acting diligently and in accordance with applicable professional standards for both parties;
- Confidentiality - Ability to refrain from disclosing any confidential information of two conflicting parties (whether confidentiality must be maintained between the two conflicting interests or two teams within a firm or company serving the two interests);
- Professional Behavior - Ability to comply with local laws and regulations.

Thus, the Task Force was able to link each fundamental principle to a COI. However, the Task Force believes the link to objectivity to be the strongest link. When serving two parties, a professional accountant's inability to remain objective may then cause the professional accountant not to perform a service with due care, or refrain from disclosing certain confidential information. The Task Force, therefore, proposes that the description be amended to link to all of the fundamental principles but that emphasis be placed on the linkage to objectivity as it "...creates a threat to objectivity and may create threats with the other fundamental principles."

It should also be noted that the new proposed language describing a COI does contain the word "objectivity." Originally the Task Force did not want to include the word "objectivity" in order to avoid a circular reference, because the phrase "conflict of interest" is included in Section 120. However, the respective section states that the "principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or undue influence of others." The term "objectivity" is not defined as a COI; a COI is

merely a reason why objectivity may be impaired and therefore, a circular reference is avoided.

**Action requested:**

The Board's feedback is requested concerning linking COI's with all of the fundamental principles while specifically mentioning objectivity.

*Proposed Description of a COI*

Based on the analysis above and comments by the Board concerning the term "professional services" and the linkage to the fundamental principles, the Task Force now proposes the following description of a COI:

"A conflict of interest arises if, when undertaking a professional activity for a party, the professional accountant has an interest or relationship other than with that party that creates a threat to objectivity and may create threats to compliance with the other fundamental principles."

**Action requested:**

The Board's feedback is requested on the proposed description of a COI.

**Review of Existing Guidance in the Code**

Having created a proposed description of the types of COI that would be addressed by the project, the Task Force considered guidance on conflicts contained in Sections 310 and 210 and paragraphs 100.17-100.22.

*Review of Section 310*

The Project Proposal states, "The objective of the project is to revise Sections 220 and 310 as appropriate..." in order to provide guidance on COI's. Therefore, the Task Force has reviewed Section 310 as a whole and is of the view that the text deals with undue pressure that a professional accountant in business may face, namely pressure to act in a way that is unlawful or unprofessional. The Section does not address situations in which a professional accountant in business is faced with a conflict of interest which threatens the accountant's ability to remain objective in undertaking professional activities, whether or not there is external pressure to act unlawfully or unprofessionally.

The Task Force has reviewed the Section on a line by line basis to determine whether the guidance provided in the Section is already addressed elsewhere in the Code. The Task Force is of the view that if the material is addressed elsewhere it should be removed from the Section in order to focus the guidance contained in Section 310 on COI's arising from

situations where the accountant is undertaking a professional activity for one party and has an interest or relationship with another party that creates a conflict.

Paragraph 310.1		
Sentence	Where it's covered in the Code	Recommended Disposition
Sentence 1: "A professional accountant in business shall comply with the fundamental principles"	Par. 100.5, Sentence 1: "A professional accountant shall comply with the following fundamental principles:" – the fundamental principles are then listed.	Delete the sentence from Section 310.1
Sentence 2: "There may be times, however, when a professional accountant's responsibilities to an employing organization and professional obligations to comply with the fundamental principles conflict."	See "Note 1"	Delete the sentence from Section 310.1
Sentence 3: "A professional accountant in business is expected to support the legitimate ethical obligations established by the employer and the rules and procedures drawn up in support of those objectives."	Par. 300.4: "A professional accountant in business has a responsibility to further the legitimate aims of the accountant's employing organization. This Code does not seek to hinder a professional accountant in business from properly fulfilling that responsibility, but addresses circumstances in which compliance with the fundamental principles may be compromised."	Delete the sentence from Section 310.1
Sentence 4: "Nevertheless, where a relationship or circumstance creates a threat to compliance with the fundamental principles, a professional accountant in business shall apply the conceptual framework approach described in Section 100 to determine a response to the threat."	Par. 100.6: "The circumstances in which professional accountants operate may create specific threats to compliance with the fundamental principles...Therefore, this Code establishes a conceptual framework that requires a professional accountant to identify, evaluate, and address threats to compliance with the fundamental principles."	Delete the sentence from Section 310.1

Note 1: The Task Force considered the second sentence of the paragraph to identify situations where a professional accountant's duty to the employing organization would be in conflict with the accountant's obligation to comply with the fundamental principles. The Task Force considered the example of aggressive earnings management – whether, for example, the accountant's duty to the employing organization to maximize shareholder return could conflict with the obligation to comply with the fundamental principles. The Task Force is of the view that aggressive earnings management could reach the point where it is contrary to professional standards. The Task Force also looked to Section 320 of the Code which states that a professional accountant in business "shall present such information fairly, honestly and in accordance with relevant professional

standards.” The Task Force, therefore, believes that the second sentence can be deleted because it is already addressed in the Code. On the other hand it was also noted that this maybe useful additional guidance for a professional accountant and should, therefore, be retained. However, the Task Force is in favour of deleting the language.

Paragraph 310.2		
	Where it's Covered in the Code	Recommended Disposition
<p>“As a consequence of responsibilities to an employing organization, a professional accountant in business may be under pressure to act or behave in ways that could create threats to compliance with the fundamental principles. Such pressure may be explicit or implicit; it may come from a supervisor, manager, director or another individual within the employing organization. A professional accountant in business may face pressure to:</p>	General description of pressure	Delete sentence
<p>Bullet point 1 &amp; 2: “Act in contrary to law or regulation. Act in contrary to technical professional standards.”</p>	Section 130, Due Professional Care and Section 150, Professional Behavior	Delete the first two bullet points from paragraph 310.2
<p>Bullet point 3: “Facilitate unethical or illegal earnings management strategies.”</p>	Par. 320.4: “Threats to compliance with the fundamental principles, for example, self-interest or intimidation threats to objectivity or professional competence and due care, are created where a professional accountant in business is pressured (either externally or by the possibility of personal gain) to become associated with misleading information or to become associated with misleading information through the actions of others.”	Delete the third bullet point from paragraph 310.2
<p>Bullet point 4 and 5: “Lie to others, or otherwise intentionally mislead (including misleading by remaining silent) others, in particular:</p> <ul style="list-style-type: none"> <li>• The auditors of the employing organization; or</li> <li>• Regulators</li> </ul> <p>Issue, or otherwise be associated with, a financial or non-financial report that materially misrepresents the facts, including statements in connection with, for example:</p> <ul style="list-style-type: none"> <li>• The financial statements;</li> <li>• Tax compliance;</li> <li>• Legal compliance; or</li> <li>• Reports required by securities regulators.”</li> </ul>	<p>Section 110, Integrity</p> <p>“The principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships</p> <p>“A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information</p> <ul style="list-style-type: none"> <li>• Contains a materially false or misleading statement</li> <li>• Contains statements or information furnished recklessly; or</li> <li>• Omits or obscures information required to be included where such omission or obscurity would be misleading.”</li> </ul>	Delete the fourth and fifth bullet point from paragraph 310.2

Paragraph 310.3		
	Where it's covered in the Code	Recommended Disposition
<p>"The significance of any threats arising from such pressures, such as intimidation threats, shall be evaluated and safeguards applied when necessary to eliminate them or reduce them to an acceptable level. Examples of such safeguards include:</p> <ul style="list-style-type: none"> <li>• Obtaining advice, where appropriate, from within the employing organization, an independent professional advisor or a relevant professional body.</li> <li>• Using a formal dispute resolution process within the employing organization.</li> <li>• Seeking legal advice."</li> </ul>	<p>Overall, the safeguards approach to any threat is thoroughly covered in Section 100 of the Code. Specifically, paragraphs 100.17 through 100.22 deal with ethical dilemmas and such threats and specifically mentions to seek legal advice or consulting those charged with governance of an organization. Finally, paragraph 100.22 states that a professional accountant shall consider removing him or herself from the engagement team or organization if a conflict cannot be resolved. It should also be noted that "intimidation threats" as mentioned in paragraph 310.3 is also addressed in paragraph 320.4.</p>	<p>Delete paragraph 310.3 from the Code.</p>

Based on the analysis above, Section 310 deals with certain pressures a professional accountant may face in complying with the fundamental principles and offers some suggested safeguards. The threats specifically apply to the professional accountant in business and his or her ability to comply with the fundamental principles while facing undue pressure from an employer. Section 310 does not deal with the situation in which the professional accountant is facing two or more competing or conflicting interests and therefore, new guidance, including new examples and new management techniques, are necessary. Besides the fact that the content of Section 310 is in need of some changes, as noted above, all of these threats and pressures can be found elsewhere in the Code and are therefore redundant. Therefore, the Task Force is recommending the deletion of Section 310. In its place, the Task Force will supply new guidance dealing with conflicting interests and competing interests along with examples of COI's that a professional accountant may face. The Task Force recommends changing the name of new Section 310 from "Potential Conflicts" to "Conflicts of Interest," to more accurately reflect the nature of the section.

The Task Force discussed other options of material for inclusion in Section 310. All members of the Task Force agreed that the material deals with undue influence and not COI's within the scope of the project. The Task Force members concurred with the analysis above, that, the material was already covered in the Code and should be removed from the section. However, other options discussed included:

- Moving some or all of the material in Section 310 to Section 110, Integrity. Ultimately, this was not the selected method of dealing with the material due to the fact that Integrity is viewed as an overarching principle and the addition of the material from Section 310 would only address one aspect of Integrity. Thus, Section 110 with the addition of the material from Section 310 may skew the information or make it "heavy" with information on undue influence.

- The Task Force considered taking the information from Section 310 and grouping it with the section subtitled “Ethical Conflict Resolution,” (Paragraphs 100.17 through 100.22). Within this recommendation the Task Force also considered grouping “Ethical Conflict Resolution” with Section 310 and create a new “Section 160” at the end of Part A dealing with the resolution of ethical dilemmas. This choice was eventually not selected by the Task Force due to the fact that moving Section 310 to Part A of the Code would include moving the management techniques of undue influence to Part A of the Code. If this is done, then it would seem inconsistent not to move the management techniques of other ethical situations to Part A of the Code. Such a trend may create a situation in which Part A of the Code would become cluttered with information that would be better suited within very specific sections of the Code in Parts B and C.
- The Task Force also considered the fact that Section 310 deals with undue influence and intimidation threats. The information naturally links to the information in paragraphs 200.8 and 300.12 of the Code, therefore, the information could be transferred to these sections. Ultimately, it was decided that paragraph 200.8 deals with intimidation threats on a firm level and not an individual level. Also, it was noted that to create a more efficient Code with the least amount of redundancy was to review Section 310, examine the Code and eliminate any portion of Section 310 already addressed.

**Action requested**

Does the Board agree that Section 310 contains material that has been covered in other sections of the Code and should therefore be deleted and replaced with a new section entitled Conflicts of Interest?

*Section 220*

The Task Force has reviewed Section 220 of the Code and noted that the material does deal with COI’s within the scope of the project. For example, the section states that “...a threat to objectivity may be created when a professional accountant in public practice competes directly with a client or has a joint venture or similar arrangement with a major competitor of a client.” The section goes on to state that other threats may occur “when interests are in conflict.” Section 220 differs from Section 310 in that it does deal with the situations created by conflicts and competition as opposed to pressures faced by professional accountants to behave in a certain way. Section 220 does need some changes including the addition of management techniques and examples. However, the Task Force is not suggesting that the material presented in Section 220 should be removed from the Code.

**Action requested**

Does the Board agree that the material in Section 220 deals with COI's?  
Does the Board agree with keeping the current information in Section 220 and proceeding forward to add to the current section?

*Paragraphs 100.17 through 100.22 – Ethical Conflict Resolution*

As noted above, while reviewing the material in Section 310, the Task Force considered the material in Paragraphs 100.17 through 100.22 while discussing the potential move of information from Section 310 to this section titled *Ethical Conflict Resolution*. The Task Force has reviewed the material in the Section and noted the following points:

- Some members of the Task Force believe that the material in this section is somewhat confusing. The title has the word “Conflict” in it, which may lead a user of the Code to assume it deals with a COI. It may also lead a user to assume the section only deals with conflicts that may occur between the fundamental principles.
- It was noted that the section may need more prominence considering the gravity of the subject. It may be better to have the subject under its own section.
- In general, the section needs to be more informative. The section is vague and may be more effective by creating examples for the user of the Code.
- Some members of the Task Force believe that the examination of this section with a view to proposing changes is beyond the scope of the project. However, other members are content to pursue the task.
- The Task Force decided to revisit the section after further conclusions have been made concerning Sections 220 and 310 of the Code.

**Action requested**

Does the Board agree that paragraphs 100.17 through 100.22 need changes in terms of examples, a title change, etc.?

If so, does the Board wish for this Task Force to examine potential changes to the said sections after more progress has been made concerning Sections 220 and 310?

### **Examples of COI's**

In order to draft guidance for Section 310 and in considering the newly proposed description of a COI, the Task Force compiled examples of COI's for professional accountants in business. The examples include:

- A professional accountant in business is charged with selecting a vendor for his or her employer. The professional accountant's spouse owns one of the potential vendors.
- A professional accountant is on a Board of Directors. The Board is selecting certain investments for the company. If the Board selects a specific investment it will increase the value of the professional accountant's own personal investment portfolio.
- A professional accountant wants to perform professional services (e.g., taxes) for two parties who are in the process of obtaining a divorce or two parties who are partners in a business that is dissolving.
- A professional accountant is on the Board of two companies and is privy to confidential information of one company that impairs his or her ability to make decisions objectively with respect to the other company due to the fact that such information could be used by the professional accountant to the advantage or disadvantage of the other company.

In each example the professional accountant:

- Is undertaking a professional activity for a party; and,
- Has an interest or relationship with another party that creates a threat to objectivity or compliance with the other fundamental principles.

The Task Force intends to reach out to member bodies to further develop examples of COI faced by accountants in business.

#### **Action requested:**

The Board is asked for feedback on the above examples.

The Board is asked to provide any other examples for consideration of inclusion into Section 310.

The Task Force considered the other material to be included in Section 310. The list is preliminary and will be considered at future meetings:

- Identification of COI's
- Evaluating COI's (reasonable third party test)
- Safeguards against the threats of COI's
  - Disclosure

- Consent
- Extra oversight/review by peer
- Consultation (with peer or member body)
- Documentation

**Action requested:**

The Board is requested to provide feedback on information that should be included in Section 310.

**Next Steps**

The Next Steps for the Task Force include:

- Continue to evaluate and develop the material to be included in Section 310 (identification of COI's, evaluation of COI's, and safeguards);
- Evaluate and develop further guidance, management techniques and examples to the existing guidance in Section 220;
- Continue to assess the description of a COI.

**Action requested:**

The Board is asked to provide feedback concerning the next steps of the Task Force.

**Material Presented**

Agenda Paper 2

This Agenda Paper

Agenda Paper 2-A

Relevant Extracts from the Code