

Conflicts of Interest

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Introduction

- Task Force met twice and conducted two conference calls to consider:
 - Description of a COI
 - Drafts of Sections 220, 310 and paragraphs 100.17 and 100.18
 - Feedback from the IESBA's February 2011 meeting
 - Impact analysis

COI in Definition Section of Code

- Task Force concluded to not create a definition of a COI to be included in the Definition Section of the Code
 - Task Force developed a description, not a definition
 - Terms in the definition are used throughout the Code, the phrase “conflict of interest” is confined to Sections 220 and 310

Changes to description of a COI

- There were questions concerning the phrase “other than with that party”
- No questions raised concerning the intent and clarity of the two bullet points of the description following opening sentence
- The two bullet points clearly state the two categories of COIs that Sections 220 and 310 address
- Modified the first sentence creating a focus on the two bullet points of the description

Description of a COI

Newly proposed description of a COI:

“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 include:

- 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.”*

Draft Sections 220, 310 & Par. 100.7-.18

Reasonable and informed third party test

- Task Force reconsidered language based on feedback of the Board
- Professional accountant required to take into account the likely views of the reasonable and informed third party throughout the entire process – identifying, evaluating and managing/addressing a COI as opposed to only during the identification phase as previously proposed

Draft Sections 220, 310 & Par. 100.17-.18

Newly proposed reasonable and informed third party test

“When identifying and evaluating the interests and relationships that might give rise to a conflict of interest and implementing safeguards, where necessary, the professional accountant in public practice, including the firm, shall 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 not compromised.”

Draft Sections 220, 310 & Par. 100.17-.18

Network firms

- Moved from stand-alone paragraph to part of paragraph 220.5, dealing with identification of a COI
- Threshold to remain at “reason to believe” a COI may exist based on:
 - Exchange of client information may vary between networks
 - Risk of not being in compliance with the fundamental principle of confidentiality
 - Threats of a COI should be evaluated consistently with that of threats to independence of non-audit assurance engagements based on paragraph 291.3, which is “reason to believe”

Draft Sections 220, 310 & Par. 100.17-.18

Inclusion of the “firm” in Section 220

- Task Force considered feedback from the Board
- The phrase “professional accountant in public practice including the firm” to be used the first time “professional accountant” is referenced in each paragraph throughout Section 220
- Throughout the remaining paragraph, only the term “professional accountant in public practice” is to be used

Draft Sections 220, 310 & Par. 100.17-100.18

Disclosure may not be possible

- Paragraph 220.7 states that disclosure of a COI is generally necessary
- Task Force considered that there are situations where disclosure of a “perceived COI” may not be possible due to
 - Breach of confidentiality, or
 - Timing of the service

Draft Sections 220, 310 & Par. 100.17-100.18

Disclosure may not be possible

- Situations where
 - The interests of client A and B may be opposed in the subject of a new engagement for client A;
 - The professional accountant or the firm holds confidential information obtained in the course of another engagement (on a different subject/matter) for client B; and,
 - That information may prejudice the interests of client A.

Draft Sections 220, 310 & Par. 100.17-100.18

Disclosure may not be possible

- Examples:
 - Hostile takeover: transaction related service for client A while client B is an audit client;
 - Forensic investigation for client A and through another engagement firm has obtained confidential information on client B who is subject to the investigation.

Draft Sections 220, 310 & Par. 100.17-100.18

Disclosure may not be possible

- Disclosure to both clients would normally be a safeguard before accepting the new engagement (as required if the services to both clients are relevant to the subject of the adverse interests between the clients)
- However, in these specific circumstances disclosure to one party would breach the duty of confidentiality to the other party.

Draft Sections 220, 310 & Par. 100.17-100.18

Disclosure may not be possible

- Therefore, Task Force drafted guidance
 - That would allow acceptance of new engagement without disclosure to the other party,
 - Provided a reasonable and informed third party would conclude the acceptance of the engagement to be acceptable, and
 - Provided that appropriate institutional mechanisms are in place to eliminate the risk of a breach of confidentiality.

Compensation Tied to Financial Reporting

Compensation and financial reporting

- Task Force charged to consider compensation being tied to financial reporting
- Section 320, *Preparation and Financial Reporting*, and Section 340, *Financial Interests* appropriately address the situation
- Task Force concluded it would be beneficial for a cross reference in Section 310, paragraph 310.8, to Sections 320 and 340

Compensation Tied to Financial Reporting

Proposed cross reference in Section 310

“A professional accountant in business may encounter other threats to compliance with the fundamental principles which may occur when preparing or reporting financial information due to undue pressure from others within the employing organization or due to financial, business or personal relationships that close or immediate family members of the professional accountant may have with the employing organization. For guidance on managing such threats, see Sections 320 and 340 of the Code.”

Compensation Tied to Financial Reporting

Proposed Titles for Sections 320 and 340

- Professional accountants may research the issue of compensation/financial reporting by scanning the table of contents, therefore the Task Force proposes new titles for the sections as follows:
 - Section 320 – Preparation and Reporting of Information and Undue Pressure
 - Section 340 – Compensation and Incentives Linked to Financial Reporting and Decision Making

Preliminary Draft Impact Analysis

- Task Force drafted preliminary impact analysis table with the following columns:
 - Current Standard
 - Proposed Change
 - Impact
 - Party Impacted
 - Direction and Magnitude
 - Duration of Impact