

Agenda Item 4

IESBA

INTERNATIONAL ETHICS STANDARDS BOARD FOR ACCOUNTANTS

545 Fifth Avenue, 14th Floor, New York, New York 10017 USA
Tel +1 (212) 286-9344 ■ Fax +1 (212) 856-9420 ■ www.iesba.org

Meeting Location: Hilton, 1335 Avenue of the Americas, New York, United States

Meeting Date: October 17 – 19, 2011

Conflicts of Interest

Objective of Agenda Item

1. To approve for exposure, proposed changes to the Code to address conflicts of interest.

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 the 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 4-A). The Task Force now presents a revised document to the IESBA for further discussion and requests the document be exposed for comments.

The Task Force has met in-person twice since the June 2011 IESBA meeting and held two conference calls. The Task Force also presented material in Agenda Paper 4-A to the CAG and received input from the CAG on September 14, 2011.

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 stated 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.

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

At its June 2011 meeting, the Board discussed whether the “reason to believe threshold” was appropriate. 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 “reasonably expected to know threshold” could create an expectation that a network would necessarily have systems to enable its member firms to know about relationships that other network firms have that may 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 a requirement to follow up and confirm or dispel the belief, 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 therefore agreed to the “reason to believe threshold” in the evaluation of conflicts of interest within a network of firms.

At the June 2011 meeting of the IESBA, most of the Board supported the proposed threshold but requested that some factors be provided that the professional accountant who has reason to believe a conflict involving a network firm exists should consider when evaluating the conflict. The Task Force agreed to add as factors to consider the structure of the network, the geographic location of its firms, and the nature of the clients served. The following language is recommended for inclusion in the bullet points of paragraph 220.5, which address 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.

CAG members generally agreed with the “reason to believe threshold” along with the additional factors to consider provided by the Task Force. CAG members agreed that networks might not have the right to share information across jurisdictional borders, thus compounding the difficulty in applying a “reasonably expected to know threshold.”

Action requested:

The Board is asked to comment on the “reason to believe threshold” for network firms in identifying conflicts of interest for evaluation.

The Board 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

At the June 2011 meeting of the IESBA, the Board agreed to include guidance within Section 220 that addresses situations where a professional accountant in public practice is asked to undertake an engagement for one client (“client A”) in circumstances where it holds confidential information received from another client (“client B”). The guidance recognizes that it would generally be necessary in such situations to seek the consent of client B before undertaking the engagement for client A. The purpose of the guidance is to establish certain conditions that are required to be met if consent cannot be obtained in such a situation due to confidentiality requirements with respect to client A.

At the June 2011 meeting of the IESBA, the Task Force presented proposed guidance concerning such situations. The Board’s feedback was as follows:

- While these situations may occur, the language should be more strict so that firms will not use this guidance as a reason not to disclose a potential conflict of interest when one may actually exist;
- The services provided in these situations should be limited to the firm providing factual data that already exists and the services should not be of an adversarial nature; and,
- The proposed guidance is too lengthy to describe a situation that does not occur frequently, which possibly over emphasizes the point.

Based on this feedback the Task Force made the following changes:

- Made the language more strict by implementing three required conditions to be met if consent cannot be obtained;
- Added language stating that the “...firm will not act in an advocacy role for one client against the other client pursuant to the engagement...”; and
- Shortened the guidance to make it more concise.

The new proposed paragraph 220.10 is as follows:

A firm may hold confidential information received from a client which could potentially damage that client’s interests if disclosed to another client of the firm. In deciding whether to accept an engagement where such information might be

relevant to the engagement, it is generally necessary for the firm to seek the consent of both clients. If the consent cannot be obtained because requesting the consent would in itself be a breach of confidentiality, the firm shall not accept the engagement unless the following conditions are met:

- *The firm will not act in an advocacy role for one client against the other client pursuant to the engagement;*
- *Institutional mechanisms are in place to eliminate the threat to confidentiality, including the risk that confidential information provided by one client could be used to its detriment as a result of the firm providing services to another client; and,*
- *The firm is satisfied, weighing all the specific facts and circumstances, that a reasonable and informed third party would conclude that it is appropriate for the firm to accept the engagement in the particular circumstances.*

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 has considered placing the example in Section 220 and in the explanatory memorandum. Including the example in Section 220 may add clarity to the guidance, however, it does make the paragraph rather lengthy.

The CAG considered the guidance and was in favour of the guidance being included in the Code as written and believed that the example added clarity and thus, should be included in Section 220 of the Code.

Action requested:

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

The Board is asked to comment on whether the example should be included in Section 220 or only within the explanatory memorandum.

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 if an arrangement exists whereby compensation is linked to the results of financial reporting. The Board agreed that these conflicts are 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 Task Force was asked to consider whether the changes to Sections 220 and 310 have implications for Sections 320 and 340 and therefore, whether certain refinements should be made to those sections, or whether the Board should add a new project to its agenda to reconsider these sections.

The Task Force agreed that Sections 320 and 340 would benefit from some refinement, and that a major rewrite of these sections would fall outside of the scope of this project. Thus, the Task Force considered the following options:

1. Propose no changes to Sections 320 and 340 and recommend a new project commence to examine both sections in greater detail. This solution would enable consideration of all changes to each section that may need to be made, particularly those outside of the Task Force's current mandate. However, this proposed solution would require that a new project be considered as part of the strategic planning process. Thus, the project may not begin for a period of time and may not be approved at all based on the other projects being proposed at the same time.
2. Propose modifications to Sections 320 and 340 to reflect certain conforming changes concerning conflicts while reporting on financial data that are within the scope of the project. This might bring recognition to the fact that the respective sections could be reconsidered as a whole within a new project.

The Task Force has proposed edits to Sections 320 and 340 as noted in proposed option 2. 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).

The Task Force presented the material in Agenda Paper 4-B to the CAG at its September 2011 meeting. The CAG believed that exposure of Sections 220 and 310 should not be unduly held up by revisions to other sections. The CAG generally agreed with the edits proposed by the Task Force.

Action requested:

The Board is asked for comments on the changes made to Sections 320 and 340 and whether or not such changes should be deferred in favour of a broad reconsideration of those sections.

Exposure Draft

Due process requires the IESBA to expose changes for a period of no less than 90 days. The Task Force is of the view that the standard period of exposure is appropriate.

An affirmative vote of two-third of IESBA members (twelve) is necessary to approve an exposure draft.

Effective date – The proposals do not call for any changes in systems and a relatively short transition period is, therefore appropriate. It is recommended that the changes become effective approximately one year after approval of the final standard.

Action Requested

IESBA members are asked to review the proposed text in Agenda Papers 4-A and 4-B and provide comment on any matters to be addressed before approving the proposed changes for release as an exposure draft.

Explanatory Memorandum

Each exposure draft is accompanied by an explanatory memorandum. This document is not approved by the IESBA but it is provided to Board members for comment. The explanatory memorandum, which will include the impact analysis, will be circulated to the Board members for comment shortly before the October 17-19, 2011 meeting.

Material Presented

Agenda Paper 4	This Agenda Paper
Agenda Paper 4-A	Paragraphs 100.17-.18 and Sections 220 and 310 with edits from the June 2011 Board Meeting and the Final Draft
Agenda Paper 4-B	Sections 320 and 340 with Proposed Edits
Agenda Paper 4-C	Explanatory Memorandum

Action Requested

1. IESBA members are asked to consider the questions raised in this Agenda Paper.