



Meeting Location: IFAC Offices, New York, USA

Meeting Date: June 18-20, 2012

Conflicts of Interest

Objective of Agenda Item

To discuss key issues raised on exposure.

Background to the Project

On December 20, 2011, the IESBA issued an exposure draft (Agenda Paper 3-C) proposing changes to the Code related to addressing conflicts of interest. The comment period ended on March 31, 2012 and 50 responses have been received as at June 6, 2012.

The Task Force¹ met on May 14-15, 2012 and by conference call on May 31, 2012 to review the comments received. The Task Force reviewed the comments and at a future meeting will provide the IESBA with a detailed analysis of all comments and the proposed resolution of each one. It has identified the key issues on which it would like the direction of the IESBA.

The majority of responses were related to Section 220. Therefore the Task Force focussed its attention on those matters. In addition the Task Force considered whether its proposals for Section 220 would be appropriate for the relevant sections of Part C of the Code. It also considered those individual comments that applied to the relevant sections of Part C of the Code.

Matters for Discussion

Overview of Responses Received

50 responses have been received (for a complete listing of responses please see Appendix A to this agenda paper). All the responses have been posted on the website and can be accessed here: <http://www.ifac.org/publications-resources/proposed-changes-code-ethics-professional-accountants-addressing-conflicts--0>.

¹ Peter Hughes (Chair), Jim Gaa, Gary Hannaford, Sylvie Soulier (Technical Advisor)

Category	Number
IFAC Member Body	28
Firms	9
Regulators and Public Authorities	5
Other Professional Organizations	7
Others	1
Total	50

Structure of Section 220

Five respondents (CPAAU, FEE, ACCA, IDW, APB) commented that the order of paragraphs 220.3-220.7 should be revised to make a clearer distinction between the identification, evaluation and management of conflicts of interests. The Task Force agrees with these comments and the proposed new order of the paragraphs is reflected in the table below. This table will help IESBA members correlate the original ED with the proposed revised wording:

<i>Exposure Draft</i>	<i>Task Force proposal</i>
<i>220.3 Reasonable steps</i>	<i>220.3 Third party test</i>
<i>220.4 Third party test</i>	<i>220.4 Reasonable steps to Identify</i>
<i>220.5 Identify and evaluate</i>	<i>220.5 Effective process</i>
<i>220.6 Effective process</i>	<i>220.6 Evaluation</i>
<i>220.7 Evaluation, disclosure, consent and safeguards</i>	<i>220.7 Safeguards</i>
	<i>220.8 Disclosure and consent</i>

Question 1: Do respondents find the description and examples of conflicts of interest helpful?

Category	Generally Agreed	Prefer Definition	Other
IFAC Member Body	19	4	4
Firms	8	1	0
Regulators and Public Authorities	3	0	1
Other Professional Organizations	4	1	2
Others	1	0	0
Total	36	6	7

36 respondents agreed with the description and examples subject to some suggested changes. Many suggested changes were additions to the list of examples and seven respondents suggested that 220.2 recognize that the list is not exhaustive. Two respondents suggested categorizing the examples.

The Task Force considered suggestions for revisions to the examples and proposes making certain changes and additions. The Task Force suggests that the examples be broadened to include situations involving an interest or relationship of a party connected to the professional accountant and other changes to the list suggested by respondents. The Task Force believes that it is sufficiently clear that the examples are not exhaustive, noting that this is the convention used to describe a non-exhaustive list throughout the Code.

The proposed revised examples are included in the Agenda Paper 3-B. The list as presented in that agenda paper may be subject to further revision by the Task Force.

Six (CPA Au, ICPAS, PAIBC, CIMA, CNCC-CSOEC, DTT) respondents stated a definition would be preferable to a description. The Task Force has used a description with examples, in preference to a definition, to make the guidance relevant in the specific context of the Code and to provide more help to Professional Accountants. It was also of the view that a definition may not capture all the necessary circumstances. The Task Force noted that no respondent had provided a definition applicable to accountants. Therefore the Task Force is of the view that a description with examples is preferable to a definition.

Three respondents (APB, NZAuSB and IOSCO) said that there should be a different standard for assurance engagements. The Task Force has considered these comments and is of the view that this project is providing guidance on conflicts of interest for all engagements and not just for assurance client relationships.

One respondent (DTT) stated that paragraph 220.1 describes circumstances that might give rise to a conflict of interest, but is not clear as to how the conflict of interest might be created, and there is no reference to the parties being in conflict. The Task Force considered the comment and is of the view that the description should provide a clearer linkage between the subject of a professional service and the existence of a conflicting interest or relationship. This in turn would help provide a better context for the later discussion of how conflicts of interest are to be identified and the factors by which they are to be evaluated. The Task Force also believes this change would help to respond to those who commented that a definition rather than a description would aid clarity.

The Task Force's proposed revised description is as follows:

220.1 *A professional accountant in public practice may be faced with a conflict of interest when performing a professional service. A conflict of interest creates a threat to objectivity and may create threats to other fundamental principles. Such threats may be created ~~by~~when:*

- ~~Conflicts~~ *The professional accountant provides professional services with respect to a particular matter for*~~between the interests of~~ *two or more clients whose interests with respect to that matter are in conflict;* or
- ~~Conflicts between~~ *The interests of the professional accountant with respect to a particular matter and the interests of the client for whom the professional accountant provides professional services with respect to that same matter are in conflict.*

Because most comments focused on Section 220 the Task Force focused its attention on the description in 220.1. It proposes conforming changes to the descriptions in 100.17 and 310.1.

100.17 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 when:

- ~~Conflicts~~The professional accountant provides professional services with respect to a particular matter for ~~between the interests of~~ two or more parties whose interests with respect to that matter are in conflict ~~for whom the professional accountant undertakes professional activities~~; or
- ~~Conflicts between~~ The interests of the professional accountant with respect to a particular matter and the interests of a party for whom the professional accountant undertakes a professional activity with respect to that same matter are in conflict.

310.1 A professional accountant in business 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 when by:

- ~~Conflicts~~The professional accountant provides professional services with respect to a particular matter for ~~between the interests of~~ two or more parties whose interests with respect to that matter are in conflict ~~for whom the professional accountant undertakes a professional activity~~; or
- ~~Conflicts between~~ The interests of the professional accountant with respect to a particular matter and the interests of a party for whom the professional accountant undertakes a professional activity with respect to that same matter are in conflict.

A party may include an employing organization, a vendor, a customer, a lender, a shareholder, or another party.

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

Action Requested

IESBA members are asked whether they agree that the description of a conflict of interest should be revised to provide a clearer linkage between the subject of a professional service and the existence of a conflicting interest or relationship.

Question 2: Do respondents find the reasonable and informed third party standard appropriate?

Category	Generally Agreed	Other Changes	Disagreed
IFAC Member Body	21	0	1
Firms	7	1	1
Regulators and Public Authorities	4	0	0
Other Professional Organizations	3	1	1
Others	1	0	0
Total	36	2	3

36 respondents expressed agreed with the reasonable and informed third party standard. The Task Force reviewed the comments, noting that the majority of respondents supported the third party test and that no significant change need be made to the draft wording.

Seven respondents (CPAB, ICAA, KPMG, ZICA, ICPAS, IRBA, RSM) while expressing agreement, noted that the third party test is subjective and a matter of judgment and cultural differences may result in inconsistent application of the test. Illustrative comment:

“We agree with the principle that the professional accountant should assess whether a reasonable and informed third party would be likely to conclude that the firm had a conflict of interest. However, any conclusion with respect to the third party test would be a matter of judgment. The IESBA should consider developing application guidance to address the third party test.” (CPAB)

The Task Force noted that this issue is not specific and unique to Conflicts of Interest and that similar comment was made in response the Breaches Exposure Draft. Staff Question & Answers on the application of the third party test have been prepared to provide additional guidance on the matter.

In response to comments from four respondents (Mazars, BDO, FEE, DTT), the Task Force proposes making changes to emphasise the need to exercise professional judgement when applying the reasonable and informed third party test and to conform the test to that used in paragraph 100.2(c) of the Code such that the test to be met is whether the reasonable and informed third party would be likely to conclude that compliance with the fundamental principles is *not* compromised.

Action Requested

IESBA members are asked whether they agree with the Task Force proposal to add a reference to professional judgement and for the test to conclude that compliance is not compromised.

Question 3: Do respondents find the “reason to believe” threshold for network firms in evaluating conflicts of interest helpful?

Category	Generally Agreed	Other Changes	Disagreed
IFAC Member Body	21	1	2
Firms	5	2	2
Regulators and Public Authorities	1	1	1
Other Professional Organizations	3	1	1
Others	1	0	0
Total	31	5	6

31 respondents expressed either complete or general agreement with the reason to believe threshold for network firms.

Six respondents (CPAB, NZAuSB, EYG, DTT, SAICA, APB) disagreed with the threshold. CPAB and NZAuSB stated the requirement should be strengthened to a “reasonably be expected to know threshold” or “knows or could reasonably be expected to know” threshold, the latter in particular for assurance engagements. DTT stated it would be disproportionate to require a search across a network and that “knows” would be an appropriate threshold. EYG stated that reasonable and informed third parties would expect a firm to make enquiries and suggested adding “...having made enquiries as appropriate of other network firms”.

The Task Force considered all the responses and is of the view that the responses were largely supportive of the “reason to believe” threshold with a small number of respondents requiring stronger and weaker thresholds. Accordingly the Task Force does not propose that amendment should be made to the general “reason to believe” test other than to include a reference to matters that the professional accountants “knows” exist.

One respondent (Mazars) stated that “there are two levels of identification of conflicts of interest: the firm level and the network level. We believe that the way the two levels of identification are presented is misleading, because the network firm perspective is presented as a sub-bullet point”. Therefore the Task Force also proposes that the reason to believe requirement should be a separate sentence within paragraph 220.6.

Action Requested

IESBA members are asked whether they agree with the Task Force’s recommendation that no significant changes need be made to the Exposure Draft wording with respect to this matter.

Question 4: Do respondents find the guidance concerning safeguards to manage conflicts of interest and obtaining and documenting consent, as set out in paragraph 220.7, appropriate?

Category	Generally Agreed	Other Changes	Disagreed
IFAC Member Body	17	8	2
Firms	7	1	1
Regulators and Public Authorities	0	2	2
Other Professional Organizations	1	3	1
Others	1	0	0
Total	26	14	6

26 respondents expressed agreed with the guidance concerning safeguards to manage conflicts of interest and obtaining and documenting consent. However, there were diverse other comments and five respondents (NZAuSB, DTT, AICPA, CICA, CPAB) did not support the guidance.

Although generally supportive, nine respondents (KPMG, BDO, FAR, CICA, CICPA, PWC, ICJCE, ACCA, GT) suggested that the guidance was insufficiently clear as a result of some of the phrases used in 220.7. Specific comments were made on the following matters:

The exposure draft says that it is “generally necessary” to disclose the nature of the conflict and to obtain written consent. Respondents requested greater guidance for when verbal or implied consent would be acceptable. NZAuSB stated: the words ‘generally necessary’ are not strong enough and should include a “shall” statement.

Three respondents (KPMG, FAR, CICA) requested examples of “implied consent”.

The exposure draft says that “in certain circumstances” consent may be implied in keeping with “common commercial practice”. Respondents stated the meaning of “common commercial practice” was unclear and that no guidance was given on what the certain circumstances may be.

Respondents also made comments about the way in which written consents are to be obtained. MIA stated that consent must be informed and in writing.

The Task Force proposes addressing the perceived lack of clarity in the paragraph by addressing disclosure and consent separately in paragraph 220.7 (now 220.8) and by placing the examples of safeguards in a separate paragraph.

The Task Force also proposes subdividing disclosure into “specific” and “general” and including guidance when general consent might be appropriate. The Task Force’s proposed revised drafting analyzes consent into verbal, written and implied, and seeks to clarify the circumstances when implied consent would be acceptable by means of an example.

The Task Force considered splitting disclosure and consent into separate paragraphs and providing more description of the circumstances in which each type of disclosure and consent may occur, but is of the view that it would not be practical in a Code that has global application to be this prescriptive. For the same reason the Task Force is of the view that it would not be appropriate to make disclosure a requirement, nor for consent in writing to be a requirement, as suggested by a minority of respondents.

Nine respondents (CNCC, JICPA, SAICA, Mazars, GT, CND, CICA, IRBA, CPAB) stated that encouraging the documentation of verbal or implied consent should be strengthened. The Task Force is of the view that on balance “encouraging” was supported by the majority of respondents.

Seven respondents did not support the guidance including for the following cited reasons:

- “The requirements with respect to consents should be strengthened. As drafted, the professional accountant is permitted to rely on implied consents or verbal consents from clients or other parties.” (CPAB)
- “It is always necessary to disclose a conflict to all affected parties and this disclosure should be in sufficient detail to allow each affected party to make a reasonable and informed decision.” (CICA)

- Generally if there is a reason why the professional accountant would not wish to disclose the nature of the conflict to one party, then it is likely that the professional accountant should not be carrying out the engagement in question.(APB)

Although a number of respondents do not support the proposals for disclosure and consent the Task Force is of the view that verbal and implied consent would be sufficient in certain situations depending on the circumstances giving rise to the conflict of interest and the significance of the conflict. The paragraph has been clarified to be more specific about the circumstances when disclosure and consent apply and strengthened to require the professional accountant to determine whether disclosure and consent should be specific depending on the significance of the conflict.

The Task Force presents an illustrative drafting of paragraph 220.8 in Agenda Paper 3-B to reflect the comments made, in particular the need for more clarity on the types of disclosure and consent. It has introduced a new requirement for the Professional Accountant to determine whether specific disclosure and consent is required in the light of the significance of the conflict of interest.

Action Requested

IESBA members are asked whether they agree with:

- separating disclosure and consent
- analyzing consent into implied, specific and general
- including a new “shall” statement requiring the professional accountant to determine whether the significance of the threat is such that specific disclosure and consent are necessary.

Question 5: Do respondents concur with the three conditions set out in paragraph 220.8 required to be met before a professional accountant can proceed to accept or continue with an engagement when a conflict of interest exists but consent cannot be obtained because it would in itself breach confidentiality? Are the examples within paragraph 220.8 helpful?

Category	Generally Agreed	Other Changes	Disagreed
IFAC Member Body	23	2	1
Firms	7	2	0
Regulators and Public Authorities	2	0	2
Other Professional Organizations	3	0	2
Others	1	0	0
Total	36	4	5

The ED proposed three conditions to be in place for an engagement to be accepted when consent cannot be obtained. 36 respondents expressed either complete or general agreement with the three conditions in paragraph 220.8.

KPMG stated that with regard to the first condition set out in 220.8, (the firm does not act in advocacy role for one client by assuming an adversarial position against the other client) there are circumstances where a firm may act in an advocacy role for one or other client without itself assuming an adversarial position. For this reason the Task Force propose changing the words to say “where this requires the firm to assume”.

Four respondents (CICA, CPAB, NZAuSB, AGNZ) did not agree with the proposal to accept an engagement as outlined in 200.8 without consent. They stated that the firm should decline the engagement. However the Task Force noted that the majority of respondents did support an exception where consent cannot be obtained without breaching confidentiality. On balance the Task Force accepted the majority view, but has strengthened the requirement by adding that the circumstances would be “exceptional”.

APB did not believe that there should be an exception to the consent requirement as currently set out in paragraph 220.8. It accepted that where appointing new advisers could produce a disproportionate and damaging adverse situation for that client, the exception should be subject to the following test: a reasonable and informed third party would consider that acting would be appropriate, having regard to the disproportionate adverse consequences to the client of declining the engagement. The Task Force considered the circumstances described to be exceptional and after some discussion agreed to strengthen the requirement by making reference to a “disproportionate adverse outcome to the clients or other relevant third parties”.

Four respondents (ICJCE, CND-CEC, ICAEW, FEE) noted that paragraph 220.7 encourages documenting consent where consent is verbal or implied but that paragraph 220.8 omitted reference to documentation. The Task Force proposes that documentation be required in the circumstances described in 220.8 (now 220.9).

Action requested

IESBA members are asked to provide comments on the Task Force's proposals.

The Task Force did not identify any points of principles arising from responses to Questions 6, 7 and 8 on which it needs the Board's direction at this time. It will review the detailed responses in more depth at a later stage and will request the Board's input at a future meeting.

Question 6: Do respondents agree with the general requirement to identify, evaluate and manage conflicts of interests as set out in proposed Section 310 of the Code?

The Task Force noted that some respondents did not comment on matters related to professional accountants in business and that all those who responded agreed with the general requirements in the Exposure Draft.

Additional comments were made on the description in 310.1 of a similar nature to those made on 220.1. The Task Force will address any changes to 301.1 consistent with the change proposed in Section 220. Proposed changes to the examples will also be addressed.

The Task Force is of the view that respondents agreed with the general requirement to identify, evaluate and manage conflicts of interests as set out in proposed Section 310 of the Code, subject to any changes that may be made to sections 100 and 220.

Question 7: Do respondents find the reasonable and informed third party test appropriate?

All respondents who responded to this question, except two, supported the third party test for PAIBs. The Task Force is of the view that respondents found the reasonable and informed third party test appropriate for PAIBs.

The Task Force noted that three respondents (PAIBC, CIMA, ICPAS) stated that the third party test is subjective and cultural differences may result in inconsistent application of the test. The Task Force noted that this issue is not specific and unique to Conflicts of Interest and that similar comment was made in response the Breaches Exposure Draft. Staff Question & Answers on the application of the third party test have been prepared to provide additional guidance on the matter.

Question 8: Do respondents find the conforming changes proposed for Sections 320 and 340 useful? Are they appropriate and adequate?

All respondents who responded to this question, except one, supported the conforming changes to sections 320 and 340. DTT stated that they could not be considered conforming changes. The Task Force is of the view that this comment is a minority view and proposes that the Exposure Draft text be retained subject only to a number of detailed suggestions that the Task Force will consider. The Task Force recommends that these comments also be considered by the Part C working group.

Question 9: Do respondents agree with the impact analysis as presented? Are there any other stakeholders, or other impacts on stakeholders, that should be considered and addressed by the IESBA?

Detailed comments on the impact analysis will be considered at a later stage. However, the Task Force notes that a number of respondents questioned the usefulness of the impact analysis given its high level nature and whether the length of the impact analysis was appropriate.

Other matters raised by respondents

The Task Force considered the issues raised by IOSCO in their letter regarding the importance of the public interest when considering conflicts of interest and the relationship between conflicts of interest and auditor independence.

IOSCO noted that the proposal did not include reference to the public interest. This view is stated in the following extract from the letter:

“The notion of a “conflict of interest” seems to implicitly suggest that there may be various identifiable interests at play during the performance of services by a professional accountant. In our view, the overarching and most important interest is the public interest. We are concerned that the proposed revisions and more broadly, the Code of Ethics, may not sufficiently and explicitly guide the accountant to use the public interest as a benchmark for his/her behavior.

We note many instances in the Code where reference is made to the professional accountant's general responsibility to use the public interest as a benchmark. We also noted, however, that the Fundamental Principles within paragraph 100.5 of the Code do not explicitly mention the accountant's responsibility to act in the public interest. We believe that acting in the public interest would entail that the auditor functions in a manner that is consistent with and/or contributes above all other interests to the efficient and effective functioning of the securities markets, including providing the relevant information to the users/investors on a timely basis. As we believe the public interest is the overarching and most important interest, we think it should be made clear within the Code that the interest of the profession or clients should never trump or come at the expense of the public interest. We believe this should be a principle explicitly set out in Paragraph 100.5 of the Code. A general principle of this nature could then be detailed in some further provisions. We would for instance suggest that the auditor be required to avoid creating new conflicts of interest, and also that he would be required, when dealing with conflicting interests, to give most weight to the public interest."

The IOSCO letter expresses the view that the public interest should be a principle explicitly set out in paragraph 100.5 of the Code, which could then be detailed in further provisions. The Task Force notes that acting in the public interest is an overarching provision in paragraph 100.1 of the Code and is of the view that a detailed consideration of this matter falls outside the remit of this project.

The IOSCO letter states there seems to be no guidance on how to deal with situations where the public interest conflicts with other interests. The Task Force is of the view that the purpose of the guidance in Section 220 is to provide guidance to the professional accountant in dealing with conflicts of interest as described paragraph 220.1 and that the public interest is addressed by the identification and evaluation of potential conflicts of interest, including in particular the application of the reasonable and informed third party test set out in paragraph 220.4.

The IOSCO letter suggests that the Board look more deeply into the relationship between conflicts of interest and auditor independence, although it recognizes this may take some time. As a first step they suggest that paragraph 220.5 should cross refer to the Independence section of the Code. The Task Force is of the view that Section 220 applies to all Professional Accountants in Practice whereas Section 290 only applies to accountants providing audit and review services and therefore a cross reference would not be appropriate.

Because of the importance of this letter, it is included in full as Agenda Paper 3-D. The IESBA may wish to consider the matters raised by IOSCO as a separate matter in a future meeting.

Action requested

IESBA members are asked to consider the disposition of the matters raised in the IOSCO letter.

Material Presented

Agenda Paper 3	This Agenda Paper
Agenda Paper 3-A	Section 220 Mark-up from Exposure Draft
Agenda Paper 3-B	Section 220 Clean
Agenda Paper 3-C	Exposure Draft
Agenda Paper 3-D	Response from the IOSCO

Action Requested

1. IESBA members are asked to address the questions set out in the agenda paper.

Appendix A

LIST OF RESPONDENTS

Proposed Changes to the Code of Ethics for Professional Accountants Addressing Conflicts of Interest

ABBR.	ORG.
MEMBER BODY	
AAT	Association of Accounting Technicians
ACCA	The Association of Chartered Certified Accountants
AICPA	American Institute of CPA
CGA	Certified General Accountants Association of Canada
CICA	The Canadian Institute of Chartered Accountants
CICPA	Chinese Institute of Certified Public Accountants
CIMA	Chartered Institute of Management Accountants
CNCC-CSOEC	Compagnie Nationale des Commissaires aux Comptes + Conseil Supérieur de l'Ordre des Experts-Comptables
CND-CEC	Consiglio Nazionale dei Dottori Commercialisti + E Degli Esperti Contabili
CPA Au	CPA Australia
FAR	FAR
FSR	Foreningen af Statsautoriserede Revisorer
HKICPA	Hong Kong Institute of Certified Public Accountants
IBR-IRE	Institut des Reviseurs d'Entreprises/ Instituut der Bedrijfsrevisoren
ICAA	The Institute of Chartered Accountants in Australia
ICAEW	The Institute of Chartered Accountants in England and Wales
ICAP	Institute of Chartered Accountants of Pakistan
ICAS	The Institute of Chartered Accountants of Scotland
ICJCE	Instituto de Censores Jurados de Cuentas de España
ICPAS	Institute of Certified Public Accountants of Singapore
IDW	Institut der Wirtschaftsprüfer
JICPA	The Japanese Institute of Certified Public Accountants
MIA	Malaysian Institute of Accountants
NBA	Nederlandse Beroepsorganisatie van Accountants
SAICA	The South African Institute of Chartered Accountants

ABBR.	ORG.
SAIPA	The South African Institute of Professional Accountants
WPK	Wirtschaftsprüferkammer
ZICA	Zambia Institute of Chartered Accountants
FIRMS	
BDO	BDO Global Coordination B.V.
DTT	Deloitte Touche Tohmatsu
EYG	Ernst & Young Global
GT	Grant Thornton International
KPMG	KPMG
Kreston International	Kreston International
Mazars & Guerard	Mazars and Guérard
PwC	PricewaterhouseCoopers
RSM	RSM International
REGULATORS & PUBLIC AUTHORITIES	
APB	Auditing Practices Board (UK)
CARB	Chartered Accountants Regulatory Board
CPAB	Canadian Public Accountability Board
IOSCO	International Organization of Securities Commissions
IRBA	Independent Regulatory Board for Auditors
INDIVIDUALS & OTHERS	
Denise Juvenal	Denise Silva Ferreira Juvenal
OTHER PROFESSIONAL ORGANIZATIONS	
APESB	Accounting Professional & Ethical Standards Board Limited-Australia
ASSIREVI	ASSIREVI - Italy
Auditor-General, NZ	Office of the Auditor-General of New Zealand
FEE	Fédération des Experts Comptables Européens
IMA	Institute of Management Accountants
NZAuASB	New Zealand Auditing and Assurance Standards Board
PAIB Committee - IFAC	Professional Accountants in Business Committee of the International Federation of Accountants
TOTAL RESPONSES	