



GUIDANCE ON CONFLICT OF INTEREST



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EXECUTIVE SUMMARY

With the increased focus on recent corporate failures, more public scrutiny is being placed on accountancy firms and their perceived ability to manage any conflict of interest that may exist in work they are undertaking or intending to undertake.

In order for there to be confidence and trust in the accountancy profession with regard to conflict of interest, a fresh approach is required. Specifically, greater emphasis needs to be placed on the ethical and public interest aspects, such that the question becomes whether the firm or member “should” undertake an engagement which involves a conflict of interest as opposed to “could”. It is therefore recommended that ICAS firms and members adopt this fresh approach as best practice when assessing whether to accept an appointment.

INTRODUCTION

- 1 Sections 220, 221 and 310 of the ICAS Code of Ethics (the Code) deal with conflict of interest. As of 1 January 2020, ICAS will introduce its Restructured and Revised Code following the approach of the International Ethics Standards Board for Accountants (IESBA) and the content on conflict of interest will be relocated in sections 210 and 310. Although the Code will be restructured, with respect to the specific sections on conflict of interest there will be no change to its substance.
- 2 The Code requires that any threats to the fundamental principles be identified, evaluated and addressed. Where the level of threat to the fundamental principles is not at an acceptable level then the matter giving rise to the threat must be eliminated, or appropriate safeguards implemented, to reduce the level of threat to an acceptable level. If the level of threat cannot be reduced to an acceptable level, then the assignment/engagement shall not be accepted. The assessment of “acceptable level” has to be carried out in the context of the mindset of a reasonable and informed third party. In relation to mitigating any threat caused by a conflict of interest, safeguards include information barriers that are integral to the firm and are not of an ad hoc nature. (Post 1 January 2020, such information barriers will no longer satisfy the definition of a safeguard but will be capable of reducing the level of any threat). There may also be a need to seek informed consent from another client, or other party, before the engagement can be accepted. However, great care must be taken to ensure that the principle of confidentiality is not inadvertently breached whilst seeking to obtain informed consent. In certain circumstances, it is unlikely to be possible to obtain informed consent without breaching confidentiality.
- 3 With the increased focus on recent corporate failures, more public scrutiny is being placed on accountancy firms and their perceived ability to manage any conflict that may exist in work they are undertaking or intending to undertake.
- 4 In light of these developments ICAS engaged a Queen’s Counsel (QC) to obtain views on the current legal situation re conflict of interest. The advice did not constitute a legal opinion. The objective of consulting with the QC was to gain a better understanding of any recent legal developments, as to how the courts view conflict of interest, and whether there was evidence that would cast doubt on the principle that a professional accountancy firm is able to manage a conflict of interest.

- 5 This guidance paper reflects both this legal advice and the evolving current practice within firms in relation to conflict of interest. The ICAS Ethics Board also encourages further developments in this area. For example, larger firms utilising their Independent Non-Executives in their conflict of interest oversight could be another step forward.
- 6 It is envisaged that this guidance will act both as guidance for firms and members, and also inform a wider debate about conflict of interest.

SUMMARY OF LEGAL VIEWS

- 7 The QC highlighted that:

"A professional adviser owes a clear duty to any client to act in the best interests of that client at all times. Anything which may or has the potential to compromise that duty is a conflict. The real issue is not identifying such a situation but how any such conflict should be dealt with."

A clear implication of this is, of course, that the firm needs to know who the client is. In situations where there are many parties, for example, a company, directors, management, and potential investors etc., it is essential that the firm is clear who it is acting for, and this is appropriately set out in the terms of engagement, and that any potential conflicts are identified and their threat levels assessed.

- 8 Nothing has emerged from recent legal cases to suggest the approach adopted in the Code, that is, managing conflict of interest, is flawed. There is no rule of law that prohibits a firm from undertaking an engagement solely on the grounds that there is a conflict, and the courts have not stated, in any case decided to date, that a conflict of interest, per se, implies a breach of professional duty. However, in the final analysis, it will depend upon the facts and circumstances of the particular case taken as a whole.
- 9 Therefore, ICAS believes that there is no need to revise its Code of Ethics (either the extant version or the restructured version to be adopted in 2020). However, certain matters were raised by the QC which we believe merit bringing to the attention of ICAS members for their consideration.
- 10 The QC highlighted that all of the guidance produced to date, including that in the Code, is somewhat open to subjective application. This includes what is meant by "informed consent" and how this can be obtained. The ability of an information barrier as the solution to preventing a potential conflict was also questioned. However, the QC did highlight that in the Prince Jefri Bolkuah case, 1999, House of Lords, the concept of "managing a conflict" was not held to be unacceptable. Lord Millett at page 237 stated that: *"there is no rule of law that Chinese walls or other arrangements of a similar kind are insufficient to eliminate the risk.....the court should restrain the firm from acting for the second client unless satisfied... that all effective measures have been taken to ensure that no disclosure will occur"*. In other words, by all means build the wall but make sure you do it properly. In that case the firm involved had not done so, but the principle is not condemned. The QC also noted that the ultimate findings against the firm, and the individual, in the MG Rover case are fact specific and do not suggest that such situations cannot,

in general, be properly managed by obtaining informed consent and having appropriate safeguards in place.

- 11 Finally, the QC flagged that a change to the approach of “managing conflicts” will only come about because the accountancy profession as a whole wants it as a matter of principle, as, up until now, the courts, despite individual criticisms, have not attacked or condemned the “managing conflict” approach.

CURRENT BEST PRACTICE

- 12 In discussions with firms, changes to how they are assessing whether to accept an engagement have been highlighted. Where an accountancy firm is considering whether to accept an appointment, the perceived reputational impact/consequences of doing so as well as any public interest implications are now playing a far more significant part in the decision-making process. The key determinant is now whether the firm “should” accept an appointment, as opposed to whether the firm “could” accept it (i.e. whether the firm is capable and can manage any conflicts that exist). This results in a more holistic assessment of whether a firm should accept an engagement.

RECOMMENDED APPROACH

- 13 Firms must have regard to the changed environment and, in particular, the public perception of accounting practice. In recent times, it has become clear that there is significant reputational risk in proceeding against the current trend of public opinion.
- 14 The ICAS Ethics Board’s guidance paper “*The Ethical Journey: The Right, the Good and the Virtuous*” (published November 2017) promotes consideration of the reputational aspects of an action as part of the ethical decision-making process to ensure that the most appropriate ethical action is ultimately taken. Until now, firms have tended to focus on whether they “could” accept an engagement involving conflict of interest. Given the changed environment, and in light of the Ethics Board’s “right, good, and virtuous” model, it is arguable that this approach is no longer appropriate. Following the Ethics Board’s model, a firm considering whether it “should” undertake an engagement which involves a conflict of interest, and having regard to reputational risk in particular, is a more appropriate approach.
- 15 ICAS believes that an assessment that is guided by the principle as to whether a firm “should” accept an engagement is more likely to better mitigate the risk that a firm suffers reputational or financial harm through a conflict of interest and better serves the public interest.
- 16 It is for individual firms to formulate an overall approach to conflict of interest. A firm may take the position that where it identifies a conflict of interest it will not act for one or more parties or decline the engagement altogether. A firm may also take the view that it will accept or continue an engagement where an identified conflict can be properly managed with appropriate safeguards in accordance with the Code of Ethics and established case law.

In forming its approach, a firm should take into account all relevant factors that it can reasonably identify including:

- (i) **Those applicable under the Code of Ethics**
 - an assessment of the nature, extent and direct and indirect implications of the conflict of interest;
 - identification of all parties whose interests might be prejudiced, informing them fully of the risk, and, having ensured that they were fully informed, obtaining their consent;
 - monitoring the engagement as it develops, and as circumstances change, to ensure that these processes are reassessed; and
 - taking steps to avoid the breaching of professional duties, including duties of confidentiality.

- (ii) **Additional considerations as to whether an engagement should be accepted**
 - whether accepting the engagement would be in accordance with the firm's ethical code;
 - how the firm's role or roles in an engagement would be perceived externally;
 - the reputational risk for the firm and the profession;
 - whether accepting the engagement would be in the public interest; and
 - whether declining to act, or to continue to act, would produce a disproportionate adverse outcome for one or more of the involved parties.

CONCLUSION

- 17 In order for there to be confidence and trust in the accountancy profession with regard to conflict of interest, a fresh approach is required. Specifically, greater emphasis needs to be placed on the ethical and public interest aspects, such that the question becomes whether the firm or member "should" undertake an engagement which involves a conflict of interest as opposed to "could". It is therefore recommended that ICAS firms and members adopt this fresh approach as best practice when assessing whether to accept an appointment.

¹ <https://www.icas.com/ethics/the-power-of-one-the-ethical-journey>, 'The Ethical Journey – The Right, the Good and the Virtuous', published by ICAS in November 2017



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