This version of the ethics learning programme is for reference only. Students must complete the online version, accessible via their dashboard, icaew.com/dashboard.

04. Conflicts of interest

After studying this module you will be able to:

- explain the ICAEW Code of Ethics approach to follow when you become aware of a conflict of interest;
- identify business v business conflicts of interest and be able to explain appropriate safeguards to deal with them; and
- identify firm v client conflicts of interest and be able to explain appropriate safeguards to deal with them.

Conflicts of Interest

1. Overview
2. Key ethical principles
3. Business v business conflict of interests
4. Client v firm conflict of interest
5. Review

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4.1.1 Overview

Conflicts of interest occur when the professional accountant or firm finds themselves in a situation where their interests conflict with those of other firms or businesses. Conflicts of interest are important because they can create threats to the fundamental ethical principles, notably confidentiality, integrity, and objectivity.

In such circumstances safeguards need to address such threats.

There are two main types of conflict of interest which will be covered in this module:

1. firm v client conflicts of interest; and
2. business v business conflicts of interest.

VIDEO – Conflicts of interest

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4.1.2 Overview

Learning outcomes

After studying this module you will be able to:

- explain the ICAEW Code of Ethics approach to follow when you become aware of a conflict of interest;
- identify business v business conflicts of interest and be able to explain appropriate safeguards to deal with them; and
- identify firm v client conflicts of interest and be able to explain appropriate safeguards to deal with them.

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4.2.1 Key ethical principles

The most applicable fundamental ethical principles for a conflict of interest are: integrity, confidentiality, and objectivity.

Integrity is important because when a conflict of interest arises it is vital that you are open and honest as soon as possible with all relevant parties.

However tempting it may be to use confidential information to gain a competitive advantage, you are always bound by a duty of confidentiality to your existing and previous clients.

If an accountancy firm is unable to manage the ethical threats created by the conflict of interest then they should stop working on engagements where they cannot act objectively.

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4.3.1 Business v business conflict of interests

Sometimes an accountancy firm will find itself with two or more clients who already have, or develop a relationship between themselves. Generally this isn't a problem for an accountancy firm unless there is a dispute between two clients, or if the clients are in competition with each other.

In such circumstances it is important that the accountancy firm does not get caught in the middle between the two clients. The accountancy firm should adopt the following approach.

Step 1: Inform both clients of the conflict of interest (integrity)
One or both clients may not be aware that a conflict of interest exists. As soon as you become aware of a client v client conflict of interest you should write to all relevant parties immediately to inform them.

Step 2: Gauge clients' reactions
It may be the case that both clients are happy to continue using the same accountancy firm; in this case there is usually no issue as long as written assurances are obtained from both clients, and information barriers are in place; no further action needs to be taken unless one or both clients raise a concern at a later stage.

Step 3: Reassure concerned clients
Clients may be concerned that sensitive information could leak to the other party through the accountancy firm. While this should not be a risk if you abide by the confidentiality principle of the ICAEW Code of Ethics, clients may understandably be looking for reassurance on this matter.

If either client is uncomfortable about sharing their accountancy firm with the other party then the firm may wish to suggest that information barriers (ie, separate engagement teams from separate geographical locations, with separate engagement partners) are set up to reduce the risk of information leaking between the two parties. Other steps that can be taken include:

- the use of confidentiality agreements signed by employees and partners of the firm;
- clear guidelines for members of the engagement teams; and
- confidential and secure data filing.

Step 4: Consider resigning from one or both of the affected clients

If either client is still uncomfortable with the situation then you must resign from one or both engagements. Usually resigning from one client is sufficient and the decision about which client to resign from is dictated by professional and ethical considerations.

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4.3.2 Business v business conflict of interests

Real-life example

When Ernst & Whinney and Arthur Young merged to form Ernst & Young (EY) in 1989 it created a problem for the new firm for two of its most high-profile clients.

Coca Cola had been an Ernst & Whinney audit client since the 1920s, while their arch rivals PepsiCo had been an Arthur Young client since the 1960s. Upon merging a conflict of interest was created between EY and these two great rivals.

EY informed both clients of the conflict of interest but, despite its best efforts, neither client was comfortable with the situation. As Coca Cola had been a client for longer, and commanded a substantially higher audit fee, EY resigned from PepsiCo.

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4.4.1 Client v firm conflict of interest

Client v firm conflicts of interest occur when the firm's (or your) interests conflict with those of the client. This may happen in circumstances such as:

- when the professional accountancy firm and the client are competing for the same engagement;
- when the firm and the client are engaged in a dispute eg, over fees; or
- when a key member of staff moves between the client and the accountancy firm.

In such situations you should consider whether you are able to continue working objectively on engagements involving that client.

The firm should take the following steps to deal with such a situation:

- contact the client, and any other relevant third party, to inform them that you believe there is a conflict of interest;
- take steps to resolve the conflict with the client; and
- if the conflict cannot be resolved, the firm should consider resigning from engagements involving that client until a resolution to the issue has been agreed.

Real-life example:

Your firm has been invited to submit a tender for a lucrative piece of consultancy work with a financial services company. Following an initial meeting with the financial services firm you discover that one of your audit clients will also be submitting a tender. You are aware that this particular audit client is currently experiencing significant financial problems and there is a question mark over their going concern status.

In this situation the first thing to do is to notify the audit client in writing of this potential conflict of interest, and then follow up with a discussion with them. If the audit client is happy for your firm to continue as their external auditor then you can do so but ethical walls between the audit engagement team and the tendering team would be advisable to keep the process as objective as possible.

If the audit client is uncomfortable with the situation then your firm will need to make a decision whether to withdraw from the tender process, or to proceed but resign from the audit client.

Regardless of whether the firm continues as the external auditor for their audit client or not, they are bound by a duty of confidentiality to them and therefore cannot disclose any information about them during the tendering process.

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4.5.1Review

This module has covered the professional accountant's approach to dealing with conflicts of interest when they arise.

This module is linked to section 220 of Part B of the ICAEW Code of Ethics.

The key learning points of the module are summarised below:

- There are two main types of conflict of interest; client v client, and firm v client.
- As soon as the professional accountant becomes aware of a potential conflict of interest they should disclose it to all relevant parties immediately.
- It is possible to manage conflicts of interest through safeguards such as information barriers. However if the conflict cannot be managed to an acceptable level then the professional accountant should consider resigning to remove the conflict of interest.

You have now reached the end of this module. Press the 'Exit' button to close this window.

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