

Conflicts of interest: Once through the murky waters

By Gary H. Barnes, Esq.

Ask 10 people to define “conflict of interest” and you are likely to get 10 different answers.

For fiduciaries, it means that the duties of the fiduciary must not be performed by one who has a private, pecuniary interest that is at odds with the interest of the entity served by the fiduciary. Such self-dealing is contrary to the principles of fiduciary service. So a corporate director cannot simultaneously be involved on behalf of the corporation in a purchase of property that the director is personally selling. Nor could a trustee of a trust sell trust property to himself/herself (or a close family member). The interest of the trust in maximizing the amount realized in the sale of its property is *in conflict* with the interest of the purchaser in paying as little as possible.

For lawyers, it means that a lawyer cannot represent parties whose interests conflict, except under very limited circumstances. Since the lawyer’s representation of a client involves standing in the client’s shoes, being the client’s voice in court, the lawyer must act with fidelity to his client’s interests.

So two persons accused of participating in a criminal activity need separate lawyers because it is likely that they may have different versions of the facts, and even more likely that the prosecution will offer a more favorable plea bargain to one defendant, creating a rift between one who may wish to plead guilty and one who may wish to go to trial. Different interests, different lawyers, because the lawyer is the representative of the client.

But what about accountants? Unlike fiduciaries, the typical engagement involves no holding of client property in trust, no responsibility to maximize a sale price. Nor do accountants typically “represent” clients in the sense of being their voice (except, of course, before the IRS).

Accountants are most typically used by their clients and others to provide an honest pair of eyes to oversee and lend credence to the work of their clients or to bring their expertise to matters that may be confounding to the lay person. This is true in both audit and other attestation engagements, just as it is true in consulting and tax preparation engagements.

For some engagements, the accounting profession requires *independence* from the client to assure that the CPA’s expression contained in the CPA’s report is not sullied by pressure from the client. Note the difference between these engagements and the lawyer’s representation of the legal client; the accountant’s engagement with independence is the theoretical opposite of the lawyer’s “stand in the client’s shoes” representation.

For other engagements, the accountant performs more like the client’s lawyer; e.g., when an accountant is engaged to be an expert witness for the client. Here, the accountant

is expected to work with the advocacy of the client's interests in mind, but, still, the accounting profession imposes limits on the CPA: the accountant may not subordinate his judgment to that of the client or the client's lawyer, nor may the CPA misrepresent facts or otherwise lose sight of objectivity. The accountant at all times, for all engagements, must act with fidelity to the principle of integrity.

From these principles flow the CPA's conflict-of-interest obligations. In the CPA's world, conflicts of interest are matters involving simultaneous engagements that would either actually impede the CPA's ability to remain objective in all of his work or appear to the eyes of those affected to sully the appearance of the CPA acting objectively and with integrity.

Add to the mix that clients do not understand the nuances of AICPA ethics rules and may be guided by lawyers who confuse the AICPA's conflict-of-interest rules with the legal conflict-of-interest rules, and you have ample opportunities for confusion, liability claims and, worse, unnecessary injuries to professional reputations.

This article is intended to shed some light on some of the more unique aspects of the AICPA's conflict-of-interest rules. We will first review the text of the pertinent rules and attempt to clarify what the rules require at a minimum. We will next attempt to condense the conflict-of-interest rules into a concise decision tree and will conclude with a model conflict-of-interest waiver form.

The AICPA Conflict-of-Interest Rule

Unlike some formulations of legal rules pertaining to conflicts of interest, the CPA's formulation derives from the requirement that a CPA must be objective in the performance of any professional service. Rule 102, entitled "Integrity and Objectivity," requires:

In the performance of any professional service, a Member shall maintain objectivity and integrity, *shall be free of conflicts of interest*, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

ET §102.01, 2 *AICPA Professional Standards* at 1771 (2010) (emphasis added).

The Code of Professional Conduct amplifies the conflict-of-interest rule, explaining when a conflict of interest occurs, identifying the type of engagements to which the conflict-of-interest rule applies and discussing when conflict-of-interest waivers may be used:

A conflict of interest may occur if a Member performs a professional service for a client or employer and the Member or his or her firm has a relationship with another person, entity, product or service that could, in the Member's professional judgment, be viewed by the client, employer or other appropriate parties as impairing the Member's objectivity. If the

Member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from such client, employer or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service. When making the disclosure, the Member should consider Rule 301, *Confidential Client Information* ET §102.03, 2 *AICPA Professional Standards* at 1771 (2010).

What the Conflict-of-Interest Rules Mean

Three important points may be derived from the above text:

- (1) A conflict of interest may be triggered by ***any professional service***.
As a practical matter, this means that a CPA must consider whether a conflict of interest exists in performing ***every*** professional service.
- (2) **A conflict of interest is defined as a perceived impairment of objectivity**, caused by the CPA's relationship with another person or entity or caused by the CPA providing services or association with a product. Essentially, this means that a CPA, as part of the acceptance of engagement process, must consider whether his objectivity might be questioned due to:
 - a. Other engagements with the CPA or his firm as previously performed or as accepted;
 - b. Whether the CPA or his firm has a relationship with another person or entity that may be perceived as impairing the CPA's or his firm's objectivity;
 - c. Whether the CPA or his firm has a relationship with the sale of any products or the furnishing of any services that may be perceived by others as impairing the CPA's or firm's objectivity; and
 - d. Whether the CPA believes that the engagement can be performed with objectivity despite the potential conflict.
- (3) Despite a conflict of interest, the AICPA rule permits the CPA or firm to accept and perform the engagement, **if appropriate waivers of conflicts of interest have been obtained**.

Unresolved Issues

Unfortunately, the rule gives little guidance on the basics of this rule. For example, there is scant guidance as to whether a conflict of interest exists if a client is particularly possessive of the accountant. Is the CPA supposed to consider what a picayune client might perceive as not objective, or what a *reasonable client* might perceive?

Similarly, in determining whether the CPA believes the engagement can be performed with objectivity, may the CPA rely upon his own personal professional judgment, or should the CPA bolster his own opinion (which may be biased in favor of accepting the engagement and getting or keeping the client) with that of a colleague whose professional judgment is not under such influences?

Finally, questions can be raised concerning conflict-of-interest waivers. What constitutes an effective waiver of a conflict of interest? The rule requires that the CPA hold the belief that the professional service can be performed with objectivity, that the “relationship is disclosed” both to the client or employer and to the other “appropriate parties” with whom the CPA has a relationship, and that the CPA obtains consent from the client or employer on whose behalf the CPA would perform the proposed engagement as well as from the other person or entity with whom the CPA has a prior or existing relationship. Among the questions unanswered are:

- (1) What must be disclosed?
- (2) How can disclosure take place consistent with confidentiality requirements?
- (3) What is required for client consent?

A Decision Tree

Nevertheless, taking each item in turn, it is possible to develop a workable “decision tree” that will allow a CPA to determine whether to reject a proposed engagement by reason of an irreconcilable conflict of interest. Boiled down to essentials, the decision tree involves four key issues:

- (1) Does the CPA have a present or past relationship with a person or entity (“other person”) that may cause either the other person or the prospective client to question the CPA’s objectivity?
 - (a) If no, there is no conflict of interest.
 - (b) If yes, proceed to questions 2.
- (2) Does the CPA believe that the proposed engagement can be performed with objectivity (impartiality, intellectual honesty), uninfluenced by the relationship with the other person?

- (a) If yes, proceed to question 3.
 - (b) If no, the proposed engagement presents an irreconcilable conflict of interest and should be declined.
- (3) Can the CPA make full disclosure of the relationship with the other person and the potential conflict with the proposed engagement without running afoul of confidentiality obligations owed to the other person?
 - (a) If yes, proceed to question 4.
 - (b) If no, informed consent cannot be obtained, and an effective client waiver cannot be obtained. The engagement must be declined.
- (4) After receiving full disclosure, will the client and the other party provide a signed written consent to the CPA's performance of the engagement?
 - (a) If yes, the engagement can be accepted.
 - (b) If no, the engagement must be declined as an unresolved conflict of interest.

Conflict-of-Interest Disclosure and Waiver Worksheet

<p>1A. Description of Proposed Client or Present Employer (“Proposed Client”) and Proposed Engagement:</p>	<p>1B. Description of third party (“Other Person”) that may be seen as impairing CPA’s objectivity and description of engagements for or relationships with Other Person that may be seen as impairing CPA objectivity:</p>
<p>2A. How might Proposed Client, when fully informed as to relationship with Other Person, perceive CPA performance of the Proposed Engagement as impairing CPA’s objectivity?</p>	<p>2B. How might Other Person perceive CPA’s performance of the Proposed Engagement as impairing CPA’s objectivity?</p>
<p>[If either 2A or 2B is answered with a perceived impairment to objectivity, a conflict of interest exists, CONTINUE. If neither reveals a perceived conflict, STOP! There is no conflict of interest, and the engagement can be undertaken without a waiver.]</p>	

3A. In the CPA's opinion, can the Proposed Engagement be performed with objectivity (i.e., with impartiality and intellectual honesty, and without influence of the Other Person)?	3B. If the Other Person is an existing client, in the CPA's opinion, can the CPA perform the Other Person's engagement with objectivity (i.e., with impartiality and intellectual honesty, and without influence of the Proposed Client)?
If 3A or 3B is answered NO, STOP! Conflict is not waivable, and engagement cannot be undertaken.	
4A. Does the CPA have confidential information pertaining to the Other Person that must be disclosed to give the Proposed Client sufficient information to understand the potential conflict of interest?	4B. Does the CPA have confidential information pertaining to the Proposed Client that must be disclosed to give the Other Person sufficient information to understand the potential conflict of interest?
If so, send letter to Other Person asking for permission to disclose [described] essential information for purpose of getting conflict waivers.	If so, send letter to Proposed Client asking for permission to disclose [described] essential information for purpose of getting conflict waivers.

5A. Will the Other Person consent to the disclosure of the confidential information?

5B. Will the Proposed Client consent to the disclosure of the confidential information?

If either 5A or 5B is answered NO, STOP! Conflict is not waivable with informed waiver, and engagement cannot be undertaken.

6A. Will the proposed Client sign a conflict-of-interest waiver?

6B. Will the Other Person sign a conflict-of-interest waiver?

If 6A or 6B is answered NO, STOP! Engagement cannot be undertaken because CPA failed to get necessary conflict-of-interest waivers. If both are answered YES, engagement can begin once all waivers are in hand.

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Disclosure and Conflict of Interest Waiver

Please read the following carefully. This firm, in accordance with the Professional Standards of the American Institute of Certified Public Accountants (“AICPA”) has determined that its acceptance of the following engagement may constitute a **conflict of interest** under those Professional Standards.

Description of Proposed Engagement:

A conflict of interest may result because you or others may perceive that this firm or the CPAs performing the above engagement (“the CPAs”) impair the CPAs impartiality, intellectual honesty or objectivity. Or you may perceive that the CPAs performance of the above-described Proposed Engagement may impair the CPAs impartiality, intellectual honesty or objectivity in the CPAs performance of duties owed to you.

The CPAs have determined that they believe they can both perform the above-described engagement and fulfill the duties owed to you in an objective, impartial and intellectually honest manner.

However, before the CPAs can accept the above Proposed Engagement, the AICPA Professional Standards require that we obtain your consent. By giving your consent, you are agreeing to waive any objection to any potential or actual conflict of interest arising from the CPAs’ acceptance or performance of the above-described Proposed Engagement.

If you consent, please sign below. If you have any questions, feel free to contact us or to consult with legal counsel.

Thank you.

[Accounting Firm Name]

I hereby consent to the performance by the CPAs of the above-described Proposed Engagement and waive any conflict of interest that may arise out of that engagement.

Signature

Date: _____

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