Statement 1.205

Conflicts of Interest and Confidential Information

(Revised with effect from 1 October 2002)

This Statement applies to all members in practice including affiliates, member firms and employees of member firms. Member firms are reminded that they are responsible for the professional conduct of non-members. Members in business should refer to Statement 1.220, Guidance on ethical matters for members in business. The Statement should be read in conjunction with Statement 1.200, Introduction and Fundamental Principles, and Statement 1.221, Definitions. For the purposes of this Statement, "member" includes "member firms". Some aspects of this Statement apply to all assurance engagements.

Members' attention is drawn to the note on application of the guidance to assurance engagements in Statement 1.221, "Definitions".

FUNDAMENTAL PRINCIPLE 1 – "Integrity"
A *member* should behave with integrity in all professional and business relationships. Integrity implies not merely honesty but fair dealing and truthfulness. A *member's* advice and work must be uncorrupted by self-interest and not be influenced by the interests of other parties.

FUNDAMENTAL PRINCIPLE 2 – "Objectivity"
A *member* should strive for objectivity in all professional and business judgements. Objectivity is the state of mind, which has regard to all considerations relevant to the task in hand but no other.

FUNDAMENTAL PRINCIPLE 3 – "Competence"
A *member* should undertake professional work only where he has the necessary competence required to carry out that work, supplemented where necessary by appropriate assistance or consultation.

FUNDAMENTAL PRINCIPLE 4 – "Performance"
A *member* should carry out his professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of him as a *member*.

FUNDAMENTAL PRINCIPLE 5 – "Courtesy"
A *member* should conduct himself with courtesy and consideration towards all with whom he comes into contact during the course of performing his work.

Introductory note and General Guidance

1.0 This Statement deals with two types of conflict of interest: (a) a conflict between the interest of a *member* or his firm and that of their client; and (b) a conflict between the interests of two or more clients.

1.1 Situations are frequently perceived by clients as 'conflicts of interest' though in reality they involve no more than concerns over keeping information confidential.

1.2 *Members'* attention is drawn to Statement 1.201, *Integrity, Objectivity and Independence*, Statement 1.202, *The Practice of Insolvency*, and to Statement 1.203, *Corporate Finance Advice*, for guidance on issues arising from certain reporting assignments, insolvency appointments and corporate finance activities.

1.3 Firms should have in place procedures to enable them to identify whether any conflicts exist and to take all reasonable steps to determine whether any conflicts are likely to arise in relation to new assignments involving both new or existing clients.

1.4 If there is no conflict of interest, firms may accept the assignment. If there is a conflict of interest, but it is capable of being addressed successfully by adoption of suitable safeguards (see paragraphs 2.2 and 7.0 *et seq*), firms should record those safeguards.

1.5 Subject to the specific provisions, particularly in Section B (below), there is, however, nothing improper in a firm having two clients whose interests are in conflict. In such a case the activities of the firm should be managed so as to avoid the work of the firm on behalf of one client adversely affecting that on behalf of another.

1.6 Where a firm believes that a conflict can be managed, sufficient disclosure (see paragraphs 2.2 and 7.0 *et seq*) should be made to the clients or potential clients concerned, together with details of any proposed safeguards, to preserve confidentiality and manage conflict.

1.7 Where a conflict cannot be managed even with safeguards, then disengagement will be necessary (see paragraphs 9.0 – 9.2)

Section A - A conflict between the interest of a *member* or his firm and that of their client

Introduction

2.0 A self-interest threat to the objectivity of a *member* or his firm will arise where there is or is likely to be a conflict of interest between them and the client or where confidential information received from the client could be used by them for the firm's or for a third party's benefit. (See Section B for detailed consideration of the holding of confidential information.)

2.1 A test is whether a reasonable and informed observer would perceive that the objectivity of the *member* or his firm is likely to be impaired. The *member* or his firm should be able to satisfy themselves and the client that any conflict can be managed with available safeguards.

Safeguards

2.2 Available safeguards may include:

- disclosure of the circumstances of the conflict;
- advising the client that, in the particular circumstances, he may wish to seek alternative independent advice;
- obtaining the informed consent of the client to act;
- establishing information barriers ('Chinese walls');
- in relation to assurance and non-assurance, insolvency and corporate finance engagements, further safeguards are identified in Statement 1.201, *Integrity, Objectivity and Independence*, Statement 1.202, *The Practice of Insolvency*, and Statement 1.203, *Corporate Finance Advice*.
- disengagement (see paragraphs 9.0 to 9.2).

Conflicts of interest arising from receipt of commission or other benefits from a third party

3.0 A self-interest threat will arise where any benefit is or is likely to be received by a *member* or his firm, or by an associate of the firm, from a third party for the introduction of a client or as a result of advice given to a client.

Safeguards

3.1 Safeguards will include:

- disclosure of a commission or other benefit

  Where a *member* or his firm becomes aware that any commission, fee or other benefit may be received by the firm or anyone in it or by an associate of the firm for the introduction of a client to a third party, or as a result of advice given to a client, the *member* or his firm should disclose to the client in writing:

  (a) that commission or benefit will result or is likely to result, and

  (b) when the fact is known, that such commission or benefit will be received, and

  (c) as early as possible, its amount and terms.

- disclosure of an association

  In making any recommendation for the use of the services of a third party, any relevant connection between that third party and the *member* or his firm should be disclosed to the client.

- obtaining the informed consent of the client

  Members are reminded that where a fiduciary relationship exists at the time between a *member* and a client, the *member* is legally bound to account to the client for any commission, fee or other benefit received from a third party. The Institute is advised that the effect is that a *member* will require the informed consent of the client if the *member* is to retain the commission, fee or other benefit or any part of it. If *members* are in doubt as to whether the circumstances give rise to a fiduciary relationship, they are recommended to seek appropriate legal advice.

More information as to the legal considerations involved is given in Statement 1.314, *Accounting for Commission.*

Section B – Safeguarding of confidential information and conflicts between the interests of two or more clients

Introduction

4.0 A number of concerns are referred to in this section, all arising out of the obligation on *members* to safeguard information received by them in confidence. This section, therefore, principally addresses the handling of confidential information.

General principles

5.0 *The nature of confidential information*

Whether information is confidential or not will depend on its nature. A safe and proper approach for *members* to adopt is to assume that all unpublished information about a client's or employer's affairs, however gained, is confidential. *Members* should recognise that some clients may regard the mere fact of their relationship with a *member* as being confidential.

Members should bear in mind that the duty of confidentiality extends not only to clients, past and present, but also to third parties from or about whom information has been received in confidence.

5.1 *The general duty to hold information in confidence*

The general obligation of a *member* is that he should never disclose or use, outside his firm, whether in his interest or that of another party, information received by him in confidence unless he has a right or obligation to do so or he has received informed consent from the party to whom the duty of confidentiality is owed.

The duty of confidentiality is not only to keep information confidential, but also to take all reasonable steps to preserve confidentiality.

Concerns facing *members*

6.0 Three concerns for *members* arising from the possession of confidential information are:

- where confidential information would be of benefit to the *member* or his firm (see paragraph 6.1);
- from the disclosure of, or failure to disclose, confidential information in accordance with legal or professional obligations (see paragraph 6.2);
- from the possession of confidential information which is relevant to an engagement for, or would be beneficial to, a client (see paragraph 6.3).

6.1 *The concern where confidential information would be of benefit to the member* or his firm.

This concern will arise where a *member* or his firm has a personal interest in the confidential information relative to the subject matter of professional services for an existing or potential client or in confidential information held about a third party.

6.2 *The concern arising out of legal or professional obligations*

It may be a criminal offence or civil wrong to disclose or use confidential information. It may be a criminal offence or civil wrong to fail to disclose confidential information. *Members* are referred to Statement 1.306, *Professional conduct and disclosure in relation to defaults or unlawful acts,* where these issues are considered in detail.

Members may, however, be entitled to disclose confidential information for the purpose of defending themselves (see paragraph 10.0). For the legal status of information about clients and employers, see paragraphs 11.0 and 12.0.

Members also have a duty to make such disclosures as are required by the Institute by virtue of its Bye-laws, Regulations or Guidance.

6.3 *The concern where confidential information is relevant to an engagement for, or would be beneficial to, a client*

A *member* must not disclose confidential information to a client even though the information is relevant to an engagement for, or would be beneficial to, that client.

Where a *member* has confidential information which affects an assurance report, or other report requiring him to state his opinion, he cannot provide an opinion which he already knows, from whatever source, to be untrue. If he is to continue the engagement, the *member* must resolve his conflict. In order to do so, the *member* is entitled to apply normal procedures and to make such enquiries as should enable him to obtain that same information but from another source. Under no circumstances, however, should there be any disclosure of confidential information outside the firm.

Safeguards

7.0 Firms should ensure that all *principals* and staff are trained in, and understand:

- the importance of confidentiality;
- the importance of identifying any conflicts of interest and confidentiality issues between clients, or between themselves or the firm and a client, in relation to a current or prospective engagement; and;
- the procedures the firm has in place for the recognition and consideration of possible conflicts of interest and confidentiality issues.

7.1 When considering acceptance of a new client, or a new engagement from an existing client, firms should consider carefully whether or not the interests of that client conflict with its own interests, or with those of another client. If the firm concludes that there is no such conflict of interest, it may accept the new client or engagement. If the firm concludes that there is or may be a conflict of interest, it should, depending on the circumstances and the nature of the conflict, either decline to accept the new client or engagement or accept the new client or engagement only with the informed consent of the prospective client and other relevant parties, or disengage.

7.2 Where the firm considers that, actually or potentially, there is a conflict of interest between clients but it is not of such a magnitude that it must decline the prospective client or engagement, it should nonetheless agree to act only if it is satisfied that adequate safeguards are available to it to counter the threat that confidential information about one of the clients may be used to that client's detriment in carrying out an engagement for the other.

7.3 In relation to preservation of confidentiality, and the perception thereof, safeguards will generally take the form of information barriers (or "Chinese Walls"), whose principal features may include:

- ensuring that there is, and continues to be, no overlap between the teams servicing the relevant clients and that each has separate internal reporting lines;

- physically separating, and restricting access to, departments providing different professional services, or creating such divisions within departments if necessary, so that confidential information about one client is not accessible by anyone providing services to another client where their interests conflict;

- setting strict and carefully defined procedures for dealing with any apparent need to disseminate information beyond a barrier and for maintaining proper records where this occurs.

The firm should ensure that the adequacy and effectiveness of the barriers are closely and independently monitored and that appropriate disciplinary sanctions are applied for breaches of them. The overall arrangements should regularly be reviewed by a designated senior partner.

It is for the *member* who erects such an information barrier to demonstrate its efficacy in keeping information confidential. It has been suggested by the courts that in some circumstances *ad hoc* information barriers may not be effective. *Members* are therefore advised to consider the need to establish institutional information barriers against the need for them arising.

7.4 **Disengagement**

It may be necessary, if none of the safeguards mentioned in paragraphs 7.0 to 7.3 is appropriate, for *member firms* to disengage *(see paragraphs 9.0 to 9.2)*

7.5 **Sole Practitioners and Small Firms**

Decisions on the part of a sole practitioner should take account of the fact that safeguards of the sort set out in paragraphs 7.3) may not be available to him, nor may they be available to a small firm where the number of partners is insufficient to spread the work.

Section C - "Whistleblowing"

8.0 The paragraphs above deal with *members'* treatment of confidential information belonging to a client or employer. There is another context in which *members* will be given or may obtain information which they must handle sensitively. *Members* may be approached in confidence with information about alleged illegal or improper actions on the part of employees or management of the business for which the informant works or with which the informant has some other relationship. A *member* may receive that information because he is trusted by the informant, or may receive it in connection with work his firm is carrying out for the informant's employer.

Whatever the circumstances in which the information comes to the *member*, he should:

- advise the informant to pass the information to his employer through the medium of the employer's own internal procedures (if they exist);

- use his best endeavours to protect the identity of the informant, taking care not to mislead the informant as to the extent to which he can do so, and should only cause the employer to be made aware of the informant's identity where this cannot be avoided; and

- take care in determining the quality of the information and how best to use it, if at all.

For a more detailed explanation of the operation of the provisions of the Public Interest Disclosure Act 1998, *members* are referred to ICAEW Technical Releases 16/99 *Receipt of Information in Confidence by Auditors* and 17/99 *Public Interest Disclosure Act 1998,* and see also paragraph 6.2 above. Members in business are reminded to consult Statement 1.220*, Guidance on Ethical Matters for Members in Business.*

Section D - Other issues

Disengagement

9.0 Where the acceptance or continuance of an engagement would, even with safeguards, prejudice the interests of any of the clients involved, the engagement should not be accepted or continued, or one of the assignments should be discontinued.

9.1 Where adequate disclosure (see paragraphs 2.2 and 7.1) is not possible by reason of constraints of confidentiality the firm should disengage from the relevant assignments.

9.2 In such circumstances disengagement should take place as speedily as possible.

Members defending themselves

10.0 There may be some situations in which a *member*, for the purpose of defending himself, may disclose confidential information. In this connection, see Statements 1.306, *Professional conduct and disclosure in relation to defaults or unlawful acts* and 1.308, *Professional conduct in relation to taxation*. Members in business should have regard to Statement 1.220*, Guidance on Ethical Matters for Members in Business.*

Requests by public authorities for confidential information

11.0 There are many situations where *members* are asked by public authorities, regulatory bodies and others to provide information about a client or employer. Such situations must be handled with care. For example, the Inland Revenue or H.M Customs & Excise may ask a *member* for information about his client's

affairs. As to such requests for information, see Statements 1.302, *Documents and Records*, and 1.308, *Professional Conduct in relation to Taxation*. In the case of requests from any other authority where the client has not consented to disclosure, it may be appropriate to seek legal advice.

Member leaving a firm

12.0 When a *member* leaves his firm or employment, he is entitled to use in his new post experience gained in previous ones but he is not entitled to use confidential information belonging to previous firms or employers, whether relating to their clients or business (see also paragraphs 5.0 and 5.1).

Confidentiality and privilege

13.0 'Confidentiality' is the duty to keep private another person's information given or obtained in confidence. 'Privilege', by contrast, is the right of a party to withhold information from the court. *Members* may be entitled to the same degree of protection from the requirement to give up information as solicitors who are able to claim "legal professional privilege". This is a difficult area, quite different from confidentiality, and legal advice should always be taken.

Legal advice and assistance

14.0 Where a *member* is in doubt as to whether he has a right or obligation to disclose, he should initially discuss the matter fully within his firm or organisation. If that is not appropriate, or if it fails to resolve the problem, he should consider taking legal advice and/or consult the Institute's Ethics Advisory Services. The Ethics Advisory Services can be contacted by e-mail ethics@icaew.co.uk or by phone 01908 248258. This service is available to all members and is a confidential service free from the duty to report misconduct. Further information on the Ethics Advisory Services can be found on http://www.icaew.co.uk/ethicsadvice.