

Conflict of Interest

A T A S K F O R C E R E P O R T



To Readers of the Conflict of Interest Task Force Report

This Task Force was formed under the auspices of the Public Interest and Integrity Committee of the CICA to ensure that the public interest is appropriately protected where actual or perceived conflicts of interest arise in relations with clients. The composition of the Task Force was designed to ensure that a wide range of interests and experience was brought to bear on the subject.

Terms of Reference

The terms of reference are as follows:

“It will consider conflicts of interest that arise because the interests of clients or potential clients of a Chartered Accountancy firm conflict and it will develop a studied response, appropriate for the profession, to the principle articulated by Mr. Justice Sopinka in *MacDonald Estate v. Martin*. In the *MacDonald* case, the Supreme Court of Canada rejected institutional devices (Chinese Walls and Cones of Silence) as an adequate response by a law firm to the objection of a party, it was retained to act against, that one of the firm’s lawyers had previously been that party’s lawyer.

The specific duty that the Supreme Court of Canada considered was the duty of confidentiality. Justice Sopinka, speaking for the court, said: “Thus, in the vast majority of cases, the courts are unlikely to accept the effectiveness of these devices until the profession, through its governing body, has studied the matter and determined whether there are institutional guarantees that will satisfy the need to maintain confidence in the integrity of the profession. In this regard, it must be borne in mind that the legal profession is a self-governing profession. The Legislature has entrusted to it and not to the court the responsibility of developing standards.”

The members of the Task Force believe that as the business world continues to evolve, and the accounting profession evolves with it, the need to protect client interests requires constant vigilance. The Task Force has attempted to clarify the duties of chartered accountants to their clients and to emphasize the need to protect confidential client information. Not all client conflicts can or should be avoided; some may be managed using institutional mechanisms suggested in this report.

The Task Force believes that changes to the rules of professional conduct should be made in order to give the profession clearer guidance on its duty to safeguard confidential client information and its duty of loyalty to clients.

Yours sincerely,

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Chair

Sept. 15, 2000

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Accountants and accounting firms owe a duty to their clients to act in their interests. This includes a duty to their clients to protect confidential client information. There are situations, however, when the interests of their clients conflict, causing an accounting firm's duties to conflict with one another.

As public accounting firms expand in size and areas of practice, firms are more frequently encountering conflicting client interests in the conduct of their day-to-day practices. The need to recognize and deal appropriately with conflicting client interests has become increasingly important.

The issue of the profession's need to maintain the confidentiality of its clients' information was addressed by the Supreme Court of Canada in the *MacDonald Estate v. Martin* case concerning the protection of confidential client information. The court has concluded that...

- There is a strong inference that members of a firm do share confidential information entrusted to them by clients; and
- This inference should be taken, unless the court is satisfied that all reasonable measures have been taken to protect the confidential client information.

The Supreme Court of Canada laid down a challenge for professions such as ours. The Supreme Court noted that since the professions are self-regulating institutions, it was for the professions themselves (not the courts) to study the matter and determine whether there are institutional guarantees that will maintain confidence in the integrity of the profession.

More recent cases have raised the issue of the professions' duty of loyalty to its clients.

The Objectives

In 1999, the CICA Public Interest and Integrity Committee established our Task Force to review conflicting client interests as they arise in the course of a CA practice. The objectives of the study were to...

- identify types of conflicting client interests.
- clarify the fiduciary duties of CAs.
- determine whether institutional mechanisms—such as Chinese Walls and Cones of Silence—may be relied upon to safeguard confidential client information and protect:
 - a) Clients from unnecessary disruption of service by their existing professional service providers; and
 - b) Members of the public from being unduly limited in their choice of a professional service provider.
- outline a process which a CA may follow to identify and address conflicts or potential conflicts.
- make recommendations with respect to the rules of professional conduct and related matters.

Our Views

This Task Force believes that...

- CA firms do have certain institutional mechanisms that may be used to protect confidential client information and thus address conflicts. The most effective use of these institutional mechanisms is assisted by early recognition of the conflict or potential conflict and the careful exercise of professional judgment as to whether, given the particular facts and circumstances, a conflict must be avoided or whether it can be managed.
- In exercising its professional judgment as to its fiduciary duty, a CA firm should ensure that, when undertaking a new assignment and throughout the course of all engagements, it is not:
 - a) violating its duty of loyalty to any existing client;
 - b) likely to disclose confidential information of another client;
 - c) acting against the interest of another client; or
 - d) achieving an undisclosed benefit for the firm or a member of it.
- CA firms should adopt an internal reporting structure to deal with the issue of conflicts and publish conflict policies internally and externally.
- CA firms should reflect their duties and any limitations in their duty to clients in their engagement letters.
- There is a need to deal with the subject of conflicts as they may affect auditor independence and objectivity. Given the many dimensions of that issue, the subjects of auditor independence and objectivity are not dealt with in this report.

The Task Force Recommends That:

1. the rules of professional conduct be changed to explicitly recognize fiduciary duty and to restrict the flow of confidential information within a CA firm to a "need to know" basis (i.e., only those persons in the firm who are working on a specific matter where confidential client information is involved should have access to such information. All persons inside a firm who obtain confidential client information should be required to protect that information).
2. the rules of professional conduct be changed to require a CA firm that is engaged on a matter where the interests of two or more clients conflict to decline to act for one or more of the clients or potential clients unless it...
 - obtains the "informed consent" of the clients or potential clients to use institutional mechanisms to fulfill its fiduciary duties to those clients; or
 - is able to clearly support its reliance on and use of institutional mechanisms on the basis of generally accepted usage in situations where no specific term of a contract with a client is being breached.
3. CA firms adopt a framework and a process for dealing with client conflicts of interest. The framework should:
 - recognize the role of professional judgment in this process; and
 - require CA firms to demonstrate that the interests of their clients will be served at a high professional standard.
4. the appropriate professional standard is one that safeguards confidential client information and ensures the fulfilment of the CA firm's duty of loyalty.
5. a standard that allows the use of institutional mechanisms is reasonable, appropriate and should be implemented. Specifically, the use of Chinese Walls to restrain the internal flow of confidential client information from one person in a CA firm to another is reasonable.
6. in order to assist CAs in the exercise of professional judgment when dealing with the need to avoid conflicts or to manage them using particular techniques, the provincial institutes/ordre provide advice on this subject through their practice advisory service.
7. the provincial institutes/ordre include within their practice inspection program a review of a CAs firm's conflict of interest policies, together with an assessment of their effectiveness.

The Accounting Profession

Professional accounting was organized in Canada and Great Britain beginning in the mid to late-1800s with the incorporation of governing bodies and the formulation of professional standards.

In Canada, provincial statutes govern the practice of public accounting. In some provinces, public accounting licenses are issued to individual CAs. In order to protect the public interest, complaints about members' conduct or competency may be heard and dealt with by both the institute/ordre and the public licensing board.

The development of professional standards of qualification, practice and discipline reflects the response of the profession to the changing economic, legal, political and social environment. The profession has used a careful and open process to develop these standards to ensure that they reflect the concerns of the public.

The Role of the CICA

The Canadian Institute of Chartered Accountants (CICA) sets accounting and auditing standards, in consultation with members of the profession and other interested parties.

Initially, the CICA's accounting guidelines outlined generally accepted accounting principles that had no legislated authority. These guidelines gradually achieved legislative recognition through references in various corporate statutes and in the securities acts. The profession summarized generally accepted auditing standards in the *CICA Handbook*. Periodic reviews (such as the recent Vision 2000 and Task Force on Standard Setting) help the profession evolve in a manner that best serves the public interest.

The Role of the Provincial Institutes/Ordre

The various provincial institutes/ordre are directly responsible for enforcing the profession's standards to further the public interest. The rules of professional conduct recognize the profession's duty to the public who rely on the objectivity and integrity of CAs. (See Rules 202 and 204 on page 13 of this report.)

NOTE:

Bermuda is a member of the CICA and is considered to be a provincial institute/ordre for these purposes.

Accounting Professionals

Today, CA firms cover a full range of sizes—from a sole practitioner to large multi-national organizations. The public may choose to obtain professional services from small firms and specialized boutiques or from larger firms offering a wide variety of services.

As firms increase in size and diversify their services, new expectations arise and the potential of conflicting client interests increases.

CA Firms in Canada Range From Sole Practitioners/Small Partnerships ...

The accounting profession in Canada includes a number of sole practitioners or small partnerships serving a small local client base.

- Many clients select a particular CA because the CA is known to have clients in the same field. The CA is therefore expected to “add value” to the audit process through his or her application of industry knowledge.
- In addition, many firms are chosen to provide business advice because they have previous experience in special areas (such as the installation of a computer system or process improvement work).

Clients of CA firms recognize that the firms will likely work for other clients on similar matters. At the same time, clients expect the firms to protect confidential client information.

... to Large Multi-Disciplinary Practices

CA firms are able to build upon their knowledge and skill sets by using the success of one engagement as the foundation for subsequent engagements. In doing so, firms have been and must continue to be careful to ensure that the future application of their knowledge base is not detrimental to their previous and continuing clients. As businesses expand, so does the demand for larger firms covering wider geographic areas that provide a high quality of service in diverse fields at the national and international level. Some CA firms are organized to provide service on a multi-national basis.

Defining Fiduciary Duties in a Firm

The duties that a CA firm has to a client arise from the relationship with the client. CA firms have several duties to their clients. Specifically, CA's have a...

- professional duty to act with integrity and due care;
- contractual duty to provide services as defined by the terms of the engagement; and
- fiduciary duty by law to protect clients' interests and protect confidentiality.

The concept of fiduciary duty is reasonably straightforward when applied to an individual CA. Challenges arise when we attempt to define fiduciary duties in firms, particularly as they increase in size and scope of function.

Fiduciary duties include the four basic rules set out on page 7 and are owed to existing clients. The fiduciary duty to former clients is more limited and involves protecting confidential client information.

The courts in both Canada and the United Kingdom appear to be prepared to recognize that the fiduciary duty of a firm can be fulfilled through the use of institutional mechanisms. Some courts have recognized specifically that institutional mechanisms are key to fulfilling a firm's fiduciary duty.

(Refer to the Appendix on pages 44 to 55.)

The Four Basic Rules

The fiduciary duty of a professional depends upon how the court views the particular facts and circumstances of the relationship between the professional and the client. The particular facts and circumstances include the standards of the profession and the expectations of the public it serves, and the terms of the contractual relationship reduced to writing (the engagement letter).

The Law Commission in the United Kingdom examined fiduciary duties and regulatory rules with a particular emphasis on financial services.

The Law Commission summarized fiduciary duties under four basic rules:

1. The "No Conflict" Rule
2. The "No Profit" Rule
3. The Undivided Loyalty Rule
4. The Duty of Confidentiality

1. The "No Conflict" Rule

A fiduciary must not place himself or herself in a position where his or her own interest conflicts with that of his or her client, the beneficiary.

2. The "No Profit" Rule

A fiduciary must not profit from his or her position at the expense of his or her client, the beneficiary.

3. The Undivided Loyalty Rule

A fiduciary must not act at the same time both for and against the same client. A consequence of his or her duty is that a fiduciary must make available to a client all the information that is relevant to the client's affairs.

4. The Duty of Confidentiality

A fiduciary must only use information obtained in confidence from his or her client, the beneficiary, for the benefit of the client and must not use it for his or her own advantage, or for the benefit of any other person.

The "no conflict" and "no profit" rule apply to the accountant's relationship with each client. These fiduciary duties are reflected in the objectivity and independence requirements of the profession and in the rule which precludes unauthorized benefits.

The undivided loyalty rule and the duty of confidentiality apply to each client and a potential problem arises for a CA firm because the interests of one or more clients may conflict.

The duty of undivided loyalty requires a CA firm to defend and advance each client's interests within the standards of the profession. This fiduciary duty is more extensive than the duty of confidentiality.

In some circumstances, the courts have imposed the same duty on an accounting firm as they would impose on a solicitor. (See Appendix pages 44 to 55)

The View of the Courts

In a Court of Law...

Here is what may happen today when a client or former client perceives a risk to its interests (because of a conflicting interest of another client) and asks the court to protect its interest.

- The CA firm is not permitted to disclose the specific information received from the client or a former client in an attempt to show there is no risk of inadvertent disclosure. The only evidence acceptable to the court is institutional in nature. The professional standards and firm practices can be referred to—but there can be no reference to the specific information confided by the client.
- Once a client or a former client shows a previous relationship with a CA which is sufficiently related to the retainer being questioned [the accountant's proposed new engagement], it will be assumed the CA has received confidential information which could prejudice the client.
- While it will be difficult, a CA firm may be able to satisfy a court that institutional mechanisms alone are sufficient to safeguard the confidential information of a client or former client.

MacDonald Estate v. Martin

The factual situation in the *MacDonald Estate* case was relatively simple. A young lawyer in one firm joined another firm. A client of the former firm challenged the right of the new firm to continue to act as counsel in an action against him. The lawyer who had joined the firm had confidential information which it was alleged would prejudice the client.

The Conclusion

In 1990, the Supreme Court of Canada in the *MacDonald Estate* case held that there was a conflict of interest but in an aside said that there may be circumstances in which the knowledge of one partner is not attributed to all members of the firm.

The Implication

In certain circumstances, where conflicting client interests are involved, the court said it may be possible to fulfill a firm's fiduciary duty by using appropriate institutional mechanisms.

The Challenge

In the *MacDonald Estate* case, the Supreme Court laid down a challenge for governing bodies. The Supreme Court noted that since the professions were self-regulating institutions, it was for the professions themselves (e.g., not the courts) to specify the circumstances and conditions in which the use of institutional mechanisms might be appropriate.

Conflicting Duties

Courts have granted injunctions in two cases that have prevented the accounting firm from accepting or completing a forensic engagement against both a former and current client (*Bolkiah* and *Drabinsky*). In both cases, the courts have held that the accountant owes the same duty as a solicitor owes to a client or former client (e.g., "The Undivided Loyalty Rule").

In another case, *Young v. Robson Rhodes*, clients who brought an action against a firm of accountants sought an injunction to stop the proposed merger of the accounting firm they engaged to testify on their behalf, with the firm they were to testify against. The court recognized the duties of confidentiality and loyalty and allowed the merger to proceed on the condition the merged firm would establish an information barrier that segregated the engaged professionals from the firm until they completed the engagement.

For a more complete consideration of these issues, refer to the Appendix on pages 44 to 55.

The Law Commission – Report No. 236

In 1995, the Law Commission in the United Kingdom considered the effect of statutory and self-regulatory controls on the fiduciary duties of professionals. This report was written in the context of the 1986 Financial Services Act and the Self-Regulating Organization created by it.

The Conclusions

The Law Commission recognized that, in today's modern commercial environment, there is a need to allow the use of institutional mechanisms to fulfill a firm's fiduciary duty. Institutional mechanisms may only be used when . . .

- the client is aware of the use of institutional mechanisms and is also aware of the restricted flow of information within a firm caused by the use of such institutional mechanisms;
- the client, on a fully informed basis, consents to the use of institutional mechanisms; and
- the effectiveness of institutional mechanisms used to fulfill the fiduciary duty can be demonstrated.

The Implication

- Firms must be able to manage conflicts by stopping information flows between departments. Today, accounting firms are increasingly utilizing Chinese Walls and Cones of Silence as effective institutional mechanisms to manage relatively simple and predictable conflict situations.
- The accounting firm and client are free to contractually define the specific fiduciary duties. In situations where there is a potential conflict between one or more clients, fiduciary duties may be agreed upon through contractual clarification. Often the engagement letter is used to obtain "informed consent" of the client.
- In a firm providing a variety of professional services with a variety of fiduciary duties, it is critical that the clients be informed as to the role that the professional will perform.

What's an Institutional Mechanism?

Institutional mechanisms are reasonable measures that are formally undertaken by a firm. These measures are designed to effectively stop the flow of confidential information obtained from a client, from one person in a firm to another. Such measures may include internal training, internal barriers such as Chinese Walls, Cones of Silence, restricted access to files, physical separation of personnel or departments and formal firm structures to identify and avoid or manage conflicts.

What is "Informed Consent"?

For the purpose of this report, "informed consent" means the client has been provided with sufficient information concerning the existence of a possible or actual conflict, its nature and the potential consequences of the conflict. The client may then make a knowledgeable decision as to whether it's in his or her best interest to proceed with the engagement.

It is recognized that, in some circumstances, it is not possible to achieve "informed consent" of both clients without breaching the duty of confidentiality of one of the clients. In such a case, the fiduciary duty cannot be fulfilled and the conflict must be avoided.

Sharing Knowledge Within a Firm

One of the underlying issues when dealing with the subject of conflicts surrounds controlling the degree to which persons in a firm share client confidences.

The rules of professional conduct currently prohibit a CA's improper use of confidential client information—but do not restrain its disclosure within a firm.

Many CAs are brought into conflict due to the general legal presumption that the knowledge of one person in a firm is shared with or attributed to all of the persons in the entire firm.

The legal presumption, that knowledge is shared within an accounting firm, often conflicts with the practice of the accounting firm (which may allow confidential information to be shared only on a “need to know” basis within the firm). This may result in a person in a firm not having knowledge which he or she is deemed to have. This may, in turn, result in an actual limitation on his or her ability to fulfill their fiduciary duty.

The “need to know” basis of sharing information, within a firm, recognizes that different persons in a firm have different needs for information in order to properly fulfill their duties. For example:

- an auditor must have information on all aspects of a client's affairs that might affect the auditor's opinion on the financial statements.
- a tax practitioner, in the course of preparing or reviewing an income tax return, must have information on all aspects of a client's affairs that might affect the income tax return.
- a forensic accountant undertaking an investigation of a client's affairs might only require information relating to the subject of the inquiry.
- a CA who is providing a professional opinion on a matter may wish to seek the advice of a professional colleague. While often this may be done on a generic basis, it may sometimes require disclosure of all the relevant facts, such that confidentiality is lost.

The Task Force believes that in order to protect confidential information, only those persons in a firm working on a matter should have access to confidential client information.



The View of the Courts

MacDonald Estate v. Martin

In the *MacDonald Estate* case, the courts examined the assumption of imputed knowledge.

The Conclusion

The courts have held there is a strong inference that partners share the confidences their clients have entrusted to them. There is a presumption the knowledge of one partner is the knowledge of all partners.

This assumption of imputed knowledge may be quite different from the reality, particularly when the culture of the profession and practices of CA firms is that information is shared only on a “need to know” basis.

The Implication

Courts are skeptical about the effectiveness of institutional mechanisms designed to preserve confidentiality. But the courts recognize that in some cases it may be both desirable and possible to reduce the risk of disclosure of confidential client information to an acceptable level through the use of certain institutional mechanisms. (Refer to the Appendix on pages 44 to 55.)

An Aside

The Task Force believes that the rules of professional conduct should explicitly recognize the use of institutional mechanisms. In so doing, the public will be provided with greater assurance that accountants will not disclose confidential information, particularly when the CA's firm is acting for two clients with conflicting objectives.

It is likely institutional mechanisms will be used increasingly as firms diversify and grow and that they will become part of the structure of the firm. But it will still be necessary for a firm to demonstrate they are effective and safeguard confidentiality and satisfy the duty of loyalty.

The firms must also inform clients and potential clients that the use of institutional mechanisms which safeguard their confidential information necessarily means the accountants providing services to them will not be aware of confidential information from other clients because of the information barriers. Accordingly, an accountant serving a particular client may not be aware of information, that is confidential to another client, which would assist the client and advance that client's interest.

Standards of Conduct

The CA profession has a responsibility to protect the public interest by ensuring that all members observe high professional and ethical standards. Rules of professional conduct and their rigorous enforcement serve as both a guide to the profession and a source of assurance of the profession's concern for the public interest.

The Public Interest

The International Federation of Accountants, of which CICA is a member, has addressed the issue of the public interest as follows as part of its "Code of Ethics for Professional Accountants":

"A distinguishing mark of a profession is acceptance of its responsibility to the public. The accountancy profession's public consists of clients, credit grantors, governments, employers, employees, investors, the business and financial community, and others who rely on the objectivity and integrity of professional accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on the accountancy profession. The public interest is defined as the collective well-being of the community of people and institutions the professional accountant services."

Proposed Changes:

In the opinion of the Task Force, the rules of professional conduct require enhancement in three areas:

- a requirement that a CA conduct any engagement on a basis which explicitly recognizes the fiduciary duty to the client;
- a requirement that on the acceptance of any new engagement the CA will assess the existence of conflicts of interest and if any exist, determine whether they: (i) are manageable, or (ii) require avoidance;
- a requirement that a CA will limit the disclosure of confidential client information within the firm to other persons within the firm on a "need to know" basis.

In order to accomplish this, we suggest that changes be made to the following rules of professional conduct:

- 204.4
- 207
- 208
- 209
- 210

Existing Rules

Extracts from the rules of professional conduct relating to conflicts of interest follow.

201 Maintenance of reputation of profession

- .1 A member or student shall conduct himself or herself at all times in a manner which will maintain the good reputation of the profession and its ability to serve the public interest.

202 Integrity and due care

A member or student shall perform his or her professional services with integrity and due care.

204.1 Objectivity: audit engagements

A member engaged as an auditor to express an opinion on financial statements or on financial or other information shall hold himself or herself free of any influence, interest or relationship which, in respect of the engagement, impairs the member's professional judgment or objectivity or which, in the view of a reasonable observer, would impair the member's professional judgment or objectivity.

.2 Objectivity: review engagements

A member engaged to conduct a review of financial statements or financial or other information and to issue a review engagement report shall hold himself or herself free of any influence, interest or relationship which, in respect of the engagement, impairs the member's professional judgment or objectivity or which, in the view of a reasonable observer, would impair the member's professional judgment or objectivity.

.3 Objectivity: insolvency engagements

A member engaged in the public practice of acting as a trustee in bankruptcy, a liquidator, a receiver, a receiver-manager or any other aspect of insolvency practice, shall hold himself or herself free of any influence, interest or relationship which, in respect of the engagement, impairs the member's professional judgment or objectivity or which, in the view of a reasonable observer, would impair the member's professional judgment or objectivity.

.4 Disclosure of conflicts

A member engaged in the practice of public accounting or any related function, in providing professional services other than those specifically provided for in Rules 204.1 or 204.2 or 204.3, shall disclose any influence, interest or relationship which, in respect of the engagement, would be seen by a reasonable observer to impair the member's professional judgment or objectivity and such disclosure shall be made in the member's written report or other written communication accompanying financial statements or financial or other information and the disclosure shall indicate the nature of the influence or relationship and the nature and extent of the interest.

Proposed Change:

Change title to...

204.4 Objectivity: Disclosure of conflicts

Existing Rules

205 False or misleading documents and oral representations

A member or student shall not

- (a) sign or associate himself or herself with any letter, report, statement, representation or financial statement which he or she knows, or should know, is false or misleading, whether or not the signing or association is subject to a disclaimer of responsibility, nor
- (b) make or associate himself or herself with any oral report, statement or representation which he or she knows, or should know, is false or misleading.

206 Compliance with professional standards

A member engaged in the practice of public accounting shall perform his or her professional services in accordance with generally accepted standards of practice of the profession, including the Recommendations set out in the CICA Handbook.

207 Informing clients and associates of possible conflicts of interest

A member engaged in the practice of public accounting or the public practice of a function not inconsistent with public accounting shall inform his or her clients or associates in such practice of any business connections, any affiliations, and any interests of which they might reasonably expect to be informed but this does not necessarily include disclosure of professional services the member may be rendering or proposing to render to other clients.

Proposed Change:

Replace old rule with...

207 Fiduciary duty

A member or student has a general fiduciary duty to his or her client or employer and, accordingly, unless expressly permitted under the provisions of Rule 208, shall not:

allow himself or herself to be placed or place another in a position where his or her own interest conflicts with that of the client or employer, or

in connection with any transaction involving a client or employer, hold, receive, bargain for, become entitled to or acquire any fee, remuneration or benefit without the client's or employer's knowledge and consent, or

allow himself or herself to be placed or place another in a position where his or her duty to one client conflicts with the duty owed to another client, or

disclose or use any confidential information concerning the affairs of any client, former client, employer or former employer except as provided in Rule 210; or

take any action, such as acquiring any interest, property or benefit, in connection with which he or she makes improper use of confidential knowledge of a client's or employer's affairs.

Existing Rules

208 Unauthorized benefits

A member or student shall not, in connection with any transaction involving a client or an employer, hold, receive, bargain for, become entitled to or acquire any fee, remuneration or benefit without the client's or employer's knowledge and consent.

209 Improper use of confidential information

A member or student shall not take any action, such as acquiring any interest, property or benefit, in connection with which he or she makes improper use of confidential knowledge of a client's affairs obtained in the course of his or her duties.

Proposed Change:

Replace old rule with...

208 Conflicting Client Interests

- .1 A member engaged in the practice of public accounting or the public practice of a function not inconsistent with public accounting, shall, before accepting any professional engagement, determine whether there is any restriction, influence, interest, or relationship, which in respect of the proposed engagement, would be seen by a reasonable observer to conflict with the member's fiduciary duty to the client or another client.
- .2 When a member determines that such circumstances exist, he or she must decline the proposed engagement unless the member's fiduciary duty can be fulfilled by reliance upon institutional mechanisms which have been generally accepted and the use of such mechanisms will not breach a specific term of an engagement with another client.
- .3 A member may not undertake an engagement that is in conflict in any respect with the interest of one or more clients or the members own interest, unless:
 - (a) the member discloses in writing to all affected clients the existence of the influences, interests or relationships which conflict, such disclosure being sufficient to properly inform the clients of the conflict and any restrictions to the terms of the engagement; and
 - (b) the member obtains the written consent of all affected clients to proceed with or continue the engagements.
- .4 Subject to the terms of the engagement, a member who, in the course of an engagement, discovers a previously unidentified conflict between clients with respect to the engagement, must withdraw from the engagement for both clients unless the provisions of Rule 208.3 are satisfied.

Proposed Change:

Delete rule 209.

Existing Rules

210 Confidentiality of information

- .1 A member or student shall not disclose or use any confidential information concerning the affairs of any client, former client, employer or former employer except:
- (a) when properly acting in the course of his or her duties;
 - (b) when such information should properly be disclosed for purposes of Rule 211 or Rule 302;
 - (c) when such information is required to be disclosed by order of lawful authority or, in the proper exercise of their duties, by the Council, the professional conduct committee or any subcommittee thereof, the discipline committee, the appeal committee, or the practice inspection committee; or
 - (d) when justified in order to defend himself or herself or his or her associates or employees, as the case may be, against any lawsuit or other legal proceeding or against alleged professional misconduct or in any legal proceeding for recovery of unpaid professional fees and disbursements, but only to the extent necessary for such purpose.
- .2 A member engaged to perform a particular service may contract for the services of a person not employed by the member to assist in the performance of that service, provided the member first obtains the written agreement of that person to carefully and faithfully preserve the confidentiality of any information acquired for the purposes of the engagement and not to make use of such information other than as shall be required in the performance of such services.

NOTE:

This summary of the existing rules and the proposed changes is provided for illustration. The rules summary has been taken from the harmonized Rules of Professional Conduct. Modifications may be required in some provinces. The proposed changes will be submitted for further deliberation by the profession's Ethics Standards Harmonization Committee.

Proposed Change:

Add...

210 Confidentiality of information

- .3 Except as provided in Rule 210.1(a), a member or student shall not disclose confidential information concerning a client or former client to a partner or other professional colleague without the written permission of the client. Where such information is shared, the partner or professional colleague is deemed to assume the fiduciary duty to the client.

Identifying Conflicts

From time to time, CA firms encounter conflicting client interests in the course of their practice. Some of these conflicts are accepted within normal commercial practice, others are avoided, and others are addressed with the consent of clients.

A CA firm’s ability to identify these conflicts—and avoid them or appropriately address them—is critical to the profession’s ability to fulfill its obligations to the public interest and maintain high professional standards.

Conflicts in a CA firm’s practice generally arise in three broad categories:

- 1. Public Practice Objectivity Issues
- 2. Protecting Confidentiality of Client Information
- 3. Pursuit of Client’s Interest to the Fullest Extent

1. Public Practice Objectivity Issues

A cornerstone of the practice of public accountancy is the provision of assurance services that are objective, both in fact and appearance. In providing assurance on financial information, CAs and their firms must not . . .

- be financially dependent upon a client;
- have relationships with clients that would affect their objectivity regarding financial information matters; and
- have relationships with, or engage in activities for, clients that would entail making managerial decisions on their behalf or otherwise impair an assurance provider’s objectivity.

2. Protecting Confidentiality of Client Information

CA firms have long recognized the need to protect the confidentiality of client information and assure clients that this information will remain private. In their role as assurance providers, CAs must have complete access to confidential client information. The CAs duty to protect the confidentiality of information may not be interfered with—except in extreme circumstances, such as a judicial or quasi-judicial order.

3. Pursuit of Client’s Interest to the Fullest Extent

A CA firm has a duty to all of its clients to provide professional service with integrity and due care. Since it will have a number of clients, it may encounter conflicting client interests when fulfilling its fiduciary duty to each client. While it may be possible for a CA firm to provide services to clients whose interests conflict, it must consider the extent of its fiduciary duty to each client and then use professional judgment to determine whether any particular conflict must be avoided or can be managed appropriately.

Generally Accepted versus Other Conflicts

Within the scope of ordinary professional practice, various conflicts can arise. Whether these conflicts are generally accepted by the public depends on whether the CA is able to balance his or her fiduciary duty with the need to...

- serve a variety of clients,
- have mobility within the profession, and
- continuously develop professional skills.

The public needs to be able to...

- have as wide a choice as possible of professionals; and
- enjoy continuity of service from valued existing professional relationships, as new matters arise.

Generally Accepted Conflicts

The following conflict scenarios reflect common commercial practice and are generally accepted by the public...

"The firm is acting for several clients who happen to compete in the same industry. They have hired us for our experience with their industry, and respect our reputation for protecting confidential information."

"I am doing an audit for Company XYZ and they have asked me to do some consulting as well. As an auditor, my duty is to report to the shareholders. As a consultant engaged by management, my duty is to the corporation."

Where clients who have been fully informed are unwilling to accept such conflicts, it is reasonable to expect that they will raise the issue at the outset.

Other Conflicts

The following conflict scenarios may or may not be accepted by the public...

"I would like to call upon the 'best expert' within my firm to assist on a particular matter for one of my clients. This 'best expert' is already committed to another client."

"The firm has two separate clients who have asked it to take on a merger and acquisition assignment—however, each client is focused on acquiring the same target company."

The following Conflict Scenarios will not be accepted and must be avoided...

"The firm has been asked by the husband and 50% shareholder, as the shareholder's auditor for Company X, for assistance in purchasing the shares of the other 50% shareholder (his wife) in settling the distribution of assets in a divorce settlement."

"The firm has been asked to complete a merger and acquisition assignment for my client but the takeover target is already a client (or former client) of the firm."

"The firm is conducting a job search engagement for a client. I have found the perfect candidate to fill the position—only this candidate is currently employed by one of our firm's clients."

"I have been asked to pursue a strategic marketing study for one of my clients—however, the firm is already undertaking a similar marketing study for another client in the same market."

Managing Conflicts

When assessing conflicts, it is often useful to consider the specific circumstances under which the conflict has occurred. Did the conflict arise while the CA was providing assurance services? Did the conflict arise while the CA was providing advisory services? In general, a conflict arising in an assurance provider setting is more easily managed than an advisory conflict.

The following is a discussion of how conflicts of interest are currently managed in the following major areas of professional practice...

- Assurance Services
- Taxation Services
- Management Consulting Services
- Merger/Acquisition Services
- Forensic Accounting and Litigation Support Services
- Valuation Services
- Insolvency Services
- Actuarial Services
- Legal Services

It is important to note that all members of a CA firm are subject to the CA profession's rules of professional conduct and that CAs in a firm are responsible for seeing that those rules are followed by all members of the firm.

Assurance Services

An auditor is likely to be involved in providing assurance services for one or more clients who have competing commercial interests.

The auditor deals with potential conflicts amongst clients by maintaining a Chinese Wall around the confidential client information of each particular assurance client. When confidential client information obtained from one client is important for use in providing assurance on the financial information of another client, the auditor will only release it with the consent of the first client.

.....

An auditor possesses confidential client information from one client that is important to the fulfillment of the assurance engagement of another client.

The auditor will only use the confidential client information for the purpose of the audit and in a manner which does not compromise the interests of the first client. If the use of the confidential information is likely to be harmful to the first client, the auditor has a conflict of interest that must be resolved.

In such circumstances, the auditor is expected to use reasonable efforts to obtain the confidential information from outside sources, and if this is not possible, the auditor will likely need to consult legal counsel with respect to the dilemma.

.....

An auditor possesses confidential client information gained in the course of the audit that would be useful in the provision of other professional services by the firm.

It is customary for confidential client information obtained in the course of the audit, to be restricted from disclosure for other purposes, unless prior permission is obtained from the client.

An auditor has the right to obtain the information that is required in order to carry out the assurance engagement.

For this reason, the auditor is expected to have all knowledge concerning the client which the firm possesses, except for information which is subject to legal privilege (i.e., information communicated to the legal services division of the firm). Thus, when Chinese Walls are used within a firm, they must be managed in such a manner that the auditor's right to necessary information is not compromised. This is often accomplished by using someone within the firm "Above the Wall." Information protected by legal privilege would be dealt with by following the established protocol for enquiries of lawyers.

A CA firm engaged to provide an assurance report to the shareholders on a set of financial statements may be asked by one shareholder for confidential client information from the audit working papers to be used by that shareholder in a dispute with another shareholder.

Since the CAs initial duty is to all of the shareholders, and the working papers are his or her property, such a request would potentially present a conflict.

Taxation Services

A tax practitioner is likely to be involved in providing tax assistance and advice to a wide variety of clients who are entitled to expect their affairs to be kept confidential.

The CA is expected to provide each client with the benefit of all of his or her professional knowledge unless it is agreed in writing that particular knowledge that he or she possesses may not be disclosed to third parties. In such case the CA is expected to disclose this restriction to the new client.

The CA firm is asked to provide tax planning advice to two clients who will use that advice to pursue an objective that only one of them can achieve.

Since both of the firm's clients are in pursuit of the same objective, there is an initial presumption that the firm can accept only the first request to act in the matter. It may, however, be possible for different persons within the firm to act for each client through the appropriate use of effective institutional mechanisms, thus rebutting the initial presumption that the firm cannot serve both clients.

A tax practitioner often maintains a continuous relationship with a number of clients, but usually obtains only a limited set of information relating to their specific matters.

In such a case, it is reasonable to believe that the CA will not be informed about all aspects of his or her firm's knowledge of a particular client and that the firm's knowledge is not automatically shared in by the CA.

Managing Conflicts (cont'd)

A management consultant may be involved in a variety of types of engagements such that conflicts which may be acceptable in one type of engagement are unacceptable in another.

Since consulting engagements usually have clearly stated objectives and a defined life span, the issue of possible conflicts of interest is often dealt with in the terms of the engagement (i.e., the extent of the fiduciary duties are agreed to by contract).

Consulting engagements may be generally regarded in three categories for the purpose of considering the issue of conflicts:

1. Process and Design Consulting;
2. Strategic Consulting; and
3. Search Consulting.

Management Consulting Services

1. Process and Design Consulting

Process and design consulting engagements occur generally where specialized knowledge is provided to assist a client achieve an objective that the client has chosen.

It is usual for a consultant to provide such assistance to a wide range of clients, some of whom may have competing interests. Often, the consultant is selected for specialized expertise. The clients recognize that in the future the consultant is likely to make that expertise available to others, building on experience gained along the way.

2. Strategic Consulting

Strategic consulting often involves a consultant assisting a client in the selection of optimum business strategies. Strategic consulting is likely to involve the most highly sensitive and confidential business information.

Consultants providing these types of services typically recognize this sensitivity and do not work for clients who are in direct competition. It is however recognized that the business strategies selected often become publicly known within a short time frame and it is therefore possible that after a suitable time frame, a consultant may undertake work for a direct competitor of a previous client. Such matters are often expressly addressed in the engagement contract.

3. Search Consulting

Search consulting involves assisting a client to locate information or resources that are necessary for the client to attain an objective.

Since the information or resource is likely to exist within another commercial enterprise, the opportunity for a conflict of interest to arise is particularly great. For this reason, it is customary for the consultant to disclose at the outset the nature and extent of any limitations on the scope of the search.

Merger/Acquisition Services

A practitioner involved in merger and acquisition activity is likely to be involved in a number of such engagements concurrently working for both existing and new clients. Where the practitioner is a member of a firm there may be several types of specialized support which the firm will offer in this area of activity ranging through...

- Due diligence;
- Tax planning;
- Market analysis; and
- Pricing the deal.

A CA involved in mergers and acquisitions is expected to use a variety of conflict management tools to provide the greatest possible assurance that confidentiality of the work will be maintained unless otherwise agreed with the client. A firm will be expected to regularly employ Chinese Walls and to impose Cones of Silence on those who are consulted in the work. Where consultations beyond the firm are required, the use of confidentiality agreements may be necessary.

Due to the nature of the work of a merger and acquisition practitioner, it is recognized that the pursuit of an engagement for one client may run contrary to the interest of another client of the firm.

When a firm uses institutional mechanisms such as Chinese Walls, it should be recognized that if their use is challenged in a court of law, the firm will be required to demonstrate that the institutional mechanisms are effective.

Even then, when one or more of the firm's merger and acquisition practitioners are working for clients pursuing approximately the same objective within approximately the same time frame, the firm, with the permission of each client, is expected to obtain the "informed consent" of all such clients, ordinarily in writing and while able to provide advice, unless specifically agreed in writing by all clients, must exclude itself from the decision-making role.

Similarly, when a firm undertakes engagements in which their clients are in direct conflict with each other there is a rebuttable presumption that the immediately preceding procedures will apply.

Forensic Accounting & Litigation Support Services

A forensic practitioner may engage in a number of different types of activity which will involve different expectations of behaviour from a client. The most common different circumstances are...

- **finder of fact (fraud investigations, breach of law investigations)**
- **quantification of losses**
- **expert accounting and auditing evidence (or where a firm employs other experts such as actuaries, engineers, and economists, these areas of expertise may also be involved).**

In almost all circumstances, there is the real possibility that their engagement may become part of the legal dispute process. There is, therefore, the expectation that the CA will respect the firm's fiduciary duty to its clients and former clients by not acting against them.

This expectation may be modified in circumstances where the client or former client engaged the firm for a narrow and unrelated purpose (such as a productivity improvement consulting assignment or an employee search assignment)—as long as the rebuttable presumption can be sustained that, in the completion of the engagement, no confidential information in relation to the current matter was obtained.

The CA may proceed with the engagement with the “informed consent” of both parties. The use of tools such as “informed consent,” Cones of Silence and Chinese Walls will assist the CA to demonstrate that confidential information will be protected and fiduciary duty fulfilled.

Circumstances where it would be appropriate for a CA to act as a finder of fact for parties on the opposing sides of a conflict would be where both parties agree to use the report of a finder of fact as an agreed statement of fact within the legal process.

Valuation Services

A valuation practitioner may or may not be a chartered business valuator.

A CA who is also a chartered business valuator will be expected to adhere to both the chartered business valuator rules of professional ethics, those of the provincial institutes/ordre of chartered accountants and to those of the firm. Valuation practitioners recognize the need to avoid conflicts of interest by avoiding representing two or more conflicting interests except after adequate disclosure to and with the consent of the clients, former clients or prospective clients concerned.

Legal Services

The provision of legal services by multi-disciplinary practices (MDPs) is presently under study in several jurisdictions. The extent to which lawyers will be permitted by their governing bodies to provide legal services through a MDP has yet to be determined.

As members of the Law Society of the province in which they practise, lawyers are required to adhere to the Society's rules of conduct including the rules about confidentiality and conflicts of interest.

The Law Society's Rules of Conduct are explicitly clear and exacting with respect to confidentiality and conflicts.

The confidentiality of information received by lawyers is recognized by the legal principle of solicitor–client privilege. Lawyers must respect the confidences of their clients.

The lawyer's duty of loyalty precludes the law firm from acting for clients whose interest conflict.

Also, lawyers are assumed to share the confidences of their clients with their partners. The risk of damage to the client's interest, on account of the lawyers knowledge of confidential information, can preclude a law firm from acting against a former client. [See Appendix pages 44 to 55]

Actuarial Services

A provider of actuarial services, as a member of the Canadian Institute of Actuaries, is expected to adhere to its rules of professional conduct, as well as those of the provincial institutes/ordre and of the firm.

Since most of the work in this area is dealing with client information, conflicts of interest are less likely, but when actuaries become involved in areas such as merger and acquisitions where conflicts do arise, they are expected to act as do other practitioners working in that area.

Insolvency Services

A provider of insolvency and corporate recovery services, as a licensed trustee and a member of the Canadian Insolvency Practitioners Association, is expected to adhere to its rules, as well as those of the provincial institutes/ordre and of the firm.

Since much of the work is carried out under the auspices of the court, a special set of rules to deal with potential conflicts exists for sorting out the various roles that a practitioner may serve. Although these rules prevent practitioners from serving roles for different classes of creditors, they do permit grouping creditors of a single class in one pool even though some of these creditors may have conflicting interests.

The Process for Dealing With Conflicts

Before taking on any engagement, a CA or firm must consider possible conflicts that may occur throughout the course of the engagement.

After conflicts and possible conflicts have been identified, a CA must exercise professional judgment as to whether the conflict must be avoided altogether by declining the engagement—or whether the conflict can be appropriately managed in a manner that will not harm another client's interests.

The process for conducting a Conflict Search involves the following five steps:

Step 1. Identify Conflicts or Potential Conflicts

Step 2. Assess the Conflicts

Step 3. Develop a Conflict Management Approach

Step 4. Assess the Effectiveness of the Conflict Management Plan

Step 5. Re-Evaluate the Plan During Engagement

Step 1: Identify Conflicts or Potential Conflicts

The CA must first identify conflicts or potential conflicts when accepting any new engagement. A conflict of interest is a conflict between the client interests and the fiduciary duties of the CA. There are three types of conflicts...

- Professional Conflicts
- Legal Conflicts
- Business Conflicts

In Step 1, the CA will perform a conflict search by utilizing the firm's conflict identification process.

Refer to pages 28 through 29 for more details.

Did the CA identify a conflict or potential conflicts?

No?
Accept the engagement.

Yes?
Continue to Step 2.

Step 2: Assess the Conflicts

After conflicts and possible conflicts have been identified, the CA must exercise professional judgment when assessing whether the conflict can be effectively managed.

It is often useful to obtain an objective professional opinion from a professional colleague in making this decision.

Refer to pages 30 through 31 for more details.

Can the conflict be effectively managed?

No?
Decline the engagement.

Yes?
Continue to Step 3.

Step 3: Develop a Conflict Management Approach

Once the CA has identified conflicts that are potentially manageable, the next step is to examine the various conflict management techniques—or institutional mechanisms—that are available within the firm to manage the conflict. Institutional mechanisms may include:

- Firm Structure
- Limited Access to Files
- Use of Employee Confidentiality Agreements
- Engagement Code names
- Cones of Silence
- Chinese Walls

As part of the Conflict Management Approach, the CA must clarify his or her fiduciary duty in an engagement letter and obtain the client's consent to proceed.

Refer to pages 32 through 36 for more details.

Step 4: Assess the Effectiveness of the Conflict Management Plan

After choosing the institutional mechanisms that will be used in the Conflict Management Plan, the CA needs to review the overall plan to see if the plan will work in practice. Remember, the onus will be on the CA to demonstrate to the courts that the institutional mechanisms were effective in protecting confidential client information.

Refer to page 37 for more details.

Is the overall plan effective?

No?

Decline the engagement.

Yes?

Use professional judgment to confirm ability to proceed. Accept the engagement.

Step 5: Re-Evaluate the Plan During Engagement

Often, client relationships span an extended period of time. Over time, it is likely that client interests may change.

In those areas of practice where relationships extend for, say, a year or more, the issue of potential conflicts should be periodically revisited to provide continued assurance that no conflicts exist.

Refer to page 37 for more details.

Does the overall plan continue to be effective?

No?

Terminate the engagement or revisit Step 3 to develop a new conflict management approach.

Yes?

Use professional judgment to confirm ability to proceed. Continue the engagement. Continue to re-evaluate conflicts during the course of the engagement.

Step 1: Identify Conflicts or Potential Conflicts

In order to identify conflicts or potential conflicts when accepting a new engagement, it is necessary to seek information from others within the firm as to the interests of other clients and their affiliations. While many conflicts are obvious from the beginning, other conflicts may arise during the course of an engagement. Often, identifying the conflicts is more difficult than dealing with the conflicts.

A conflict of interest is a conflict between client interests and the professional responsibilities of a person in a position of trust. There are three types of conflict which may overlap:

1. Professional conflicts
2. Legal conflicts
3. Business conflicts

1. Professional Conflicts

- A CA has a duty to the profession to act in a manner that maintains the good reputation of the profession and its ability to serve the public interest (Rule 201). When a CA's duty to the profession runs contrary to a client's interest, a professional conflict exists.
- In addition, a CA is obligated by the rules of professional conduct not to knowingly be associated with information that is materially false or misleading (Rule 205).
- The professional standards also include most of the legal conflicts imposed by the professional's fiduciary duty (Rules 204, 207, 208, 209 and 210), and such standards apply to non-CA members of the firm as well. The range of various professional interests is dealt with further in this report.

2. Legal Conflicts

- Legal conflicts of interest arise primarily out of a CA's fiduciary duty or specific contractual agreements. A CA and the firm have a duty within the standards of the profession to pursue the client's interest to the utmost and to protect confidential client information. Thus when two clients have conflicting interests, the firm cannot fulfill a duty to both unless appropriate institutional mechanisms are in place.
- In addition, when a CA is acting within the framework of litigation or potential litigation, the courts will want to ensure that the legal process is not compromised by participants, who act as experts, being influenced by interests or relationships which impair or might impair their objectivity.

3. Business Conflicts

Business conflicts occur when the business interest of a client is contrary to the business interest of the CA or the firm or the business interest of another of their clients. Business interests (in the sense of enhancing the profit of the firm or advancing the career of a professional) may also conflict with professional or legal duties of an individual or firm to existing clients.

A CA firm may face any one of the following business conflicts...

- the firm is already working for a competitor.
- a particular assignment may require too large a commitment of scarce resources in the firm.
- the firm is dissatisfied with the risk/reward analysis.
- the firm's current engagement may affect the the firm's ability to accept a future engagement from another client or potential client.
- a current engagement may require the firm to change a previously stated position.
- the provision of service by one service area of a firm may preclude the provision of service by other areas of the firm to another client.
- a course of action may be contrary to the personal business interests of one or more members of a firm (or their families).
- the firm is aware of a potential client's unsatisfactory reputation.

Identifying Conflicts

A firm should maintain an information base that is organized to enable a conflict enquiry to proceed. Each firm should develop its own conflict identification process. This process should include a client information base and a system that allows for timely access to the information base so that real or potential conflicts can be recognized promptly.

The Challenges

- It is difficult to foresee the future business paths that may be taken by clients—thereby avoiding conflict.
- A centralized body of knowledge of the activities of clients is difficult to develop and manage.
- It is challenging to anticipate and avoid conflicts that may arise between clients of different persons within a firm.
- With the complexity of modern business structures, even well designed client information databases, will have difficulty identifying all conflicts or potential conflicts.
- Unlimited access to databases that contain confidential information may, by itself, be seen to disclose confidential client information.
- For areas of practice where conflicts must usually be avoided rather than managed, a firm's conflict identification process will likely need to be more extensive and formal.

The Benefit

An effective conflict identification process will allow a firm to identify conflicts (or possible conflicts) early on in an engagement. The earlier a potential conflict is identified, the greater the chance the firm will be able to choose to manage the conflict—rather than avoid the engagement altogether.

Step 2: Assess the Conflicts

After conflicts and possible conflicts have been identified, a CA must exercise professional judgment as to whether the conflict must be avoided altogether by declining the engagement—or whether the conflict can be appropriately managed (i.e., in a manner which can be demonstrated not to risk harming other client interests).

When assessing the conflict, consider the following questions...

Managing Business Conflicts

Most decisions to avoid business conflicts of interest will be made by a CA or the firm based on a desire to retain the confidence of and relationship with existing clients. For this reason...

- A CA may agree that specialized work of a particular nature will not be undertaken for a direct competitor.
- A CA may agree to seek permission before providing a particular service to other clients.
- In some circumstances, a CA will unilaterally feel obliged to decline an engagement if the CA recognizes that the business relationship with a particular client might be jeopardized.

Questions to Consider

1. Does the conflict hinder the CA's abilities to perform his or her duties?

The following is a list of considerations...

L E G A L

Confidentiality of information

The duty of confidentiality does not expire with time. As confidential information becomes dated the duty may be of less practical concern to a client, but the duty continues.

No conflict of goals

Another part of a CA's fiduciary duty to the client is to pursue the client's interest to the utmost within the standards of the profession. Clearly when the interest of one client is opposite to that of another, the firm's relationship with both clients must be appropriately managed.

No undisclosed profit to the practitioner

A CA's client should expect to pay for a CA's service on an explicitly disclosed and agreed basis. In the absence of such agreement, a client can expect to be charged on a time-related basis, and there should be no direct or indirect benefit or compensation beyond that to the firm or a member of it.

Loyalty in the pursuit of client's interest

The duty of confidentiality does not exhaust the duty of loyalty. The fiduciary duty of loyalty to the client requires the CA to advance the client's interest with all of his or her relevant knowledge.

P R O F E S S I O N A L

Integrity and due care

The client of a CA firm is entitled to expect that all members of the firm will perform their services with integrity and due care.

Reputation of the profession

In order to preserve the highest possible standards for the CA profession as a whole, each CA under the rules of professional conduct is expected to engage only in activities that will maintain the good reputation of the profession and its ability to serve the public interest.

B U S I N E S S

Reputation of the firm

It is expected that firms will provide services in a manner that enhances the reputation of the profession. It is also expected that they will operate to enhance their own reputation.

Adherence to contract

In many engagements, the terms are explicitly agreed upon by the CA and the client. These may include provisions dealing with conflicts of interest.

Act in interest of the client

Clients are generally entitled to expect that professionals are acting in their interest unless they are otherwise informed of any limitations.

2. What will be the impact on the client's ability to obtain professional services should the CA choose to decline the engagement?

In smaller communities where there are fewer CAs available to serve clients' needs, there will be more occasions when it is necessary to manage conflicts.

3. If the CA is capable of managing a particular conflict, will the appearance of a conflict be sufficient cause for the CA to avoid the conflict (and the engagement) entirely?

The courts are concerned with even the appearance of a conflict.

4. Is it likely that the work resulting from this engagement will go before the court? And if so, is it likely that a court of law would deem the conflict unacceptable?

An example of a conflict that would be deemed unacceptable by a court of law is a scenario where two clients are directly disputing an issue with each other and which, potentially, may be adjudicated in a court of law. (An exception to this is where the CA is asked to act as a finder of facts by both parties).

5. Will the institutional mechanisms available to the CA be effective in managing the conflict?

This will be determined by the facts in the situation. Remember, the onus will be on the CA to demonstrate to the courts that the institutional mechanisms were effective in protecting confidential client information.

6. Will the CA's decision to avoid the conflict by resigning from the engagement be a commercially satisfactory solution for the client?

In many cases, the solution to avoid the conflict by resigning from the engagement with each of the clients will not be a commercially satisfactory solution for either one of the clients or the practitioner. For example, the equal duty of an auditor to all of the shareholders of a client makes it difficult to resign to avoid a conflict that might arise between two groups of shareholders. This places particular onus on all of the parties to manage the conflict, rather than force the CA to resign.

Once the CA has identified the conflict and assessed its impact, he or she may decide to...

A. Decline/Terminate the Engagement

For those conflicts that are not possible or appropriate to manage, the CA should inform the client that the engagement will be declined or terminated.

B. Develop an Effective Conflict Management Approach

For manageable conflicts, the next step is to develop an effective Conflict Management Approach—with the “informed consent” of the client.

Remember

A CA's decision to manage a conflict situation may be subjected to challenge.

C. Take No Action

For those conflicts which, by reason of their common acceptance in practice, it is deemed not necessary to manage through special procedures or obtaining consent, no action is required.

Step 3: Develop a Conflict Management Approach

Once the CA has identified conflicts that are potentially manageable, the next step is to examine the various institutional mechanisms (conflict management techniques) that are available within the firm to manage the conflict.

A Conflict Management Approach is then developed, incorporating the various institutional mechanisms selected. Each Conflict Management Approach must be effective and have the appearance of being effective.

How?

Here's how to develop an effective Conflict Management Approach...

1. Choose the institutional mechanisms (refer to pages 32 through 35).
2. Provide disclosure and obtain client consent (refer to page 36).

1. Choose the Institutional Mechanisms

The following institutional mechanisms may be incorporated in an effective Conflict Management Approach...

- A) Firm Structure
 - limited access to files
 - use of employee confidentiality agreements
 - engagement Code Names
- B) Chinese Walls
- C) Cones of Silence

Documentation

Since problems with the management of conflicts may arise in the future, it is important to document the process by which conflicts are assessed and managed.

When developing a Conflict Management Approach, the CA firm must ensure the conflict management techniques selected are robust enough to demonstrate that the client's interest will be served within the terms of the engagement.

The use of such techniques requires the use of professional judgment since ultimately their effectiveness and therefore their acceptability will be judged using the standard of "the expectation of a reasonable person."

A) Firm Structure

A firm may organize itself in a variety of ways to deal with conflict issues, such that its organization itself becomes an effective conflict management technique.

A firm may adopt some or all of the following conflict techniques as part of its organizational structure...

Implement an Engagement Reporting Structure that is overseen by a Conflicts Management Committee. The Conflicts Management Committee's role is to identify, at the outset, potential conflicts—and decide whether to avoid the conflict or manage it. Members of such a committee should be "Above the Wall".

Maintain a central list of clients, shareholders, officers and directors of clients, and engagements. This list would enable firm-wide access to issues that may cause conflict.

Restrict Access. Often, persons within a firm have access to non-public information that has been received by several parties within the firm. Clients of the firm could view this situation as a conflict. Firms may choose to restrict access of particularly sensitive information to particular persons.

Maintain an Archival System to enable firm-wide access to knowledge of completed engagements.

Adopt a Formal Compliance Oversight Role. One or more persons in a firm may take on a "formal compliance oversight" watchdog role. Persons in a firm would be expected to inform these compliance watchdogs of possible conflicts—and receive assistance when exercising professional judgments with respect to conflict management. Some persons in a firm will have to be "Above the Wall" and be able to use professional judgment to deal with conflicts.

Adopt Formal Conflict Management Policies that provide members with guidance on dealing with conflicts. These formal policies also inform clients as to what they should expect when agreeing to allow a firm with a conflict to act on their behalf.

Create separate areas of practice for specialty functions within the firm. This separation may act as a barrier to the passing of confidential client information from one practice area to another within a firm. (This will not, however, address conflicts which arise within a single area of practice.)

The flow of information from one area to another is restricted by a formal set of rules. Within each separate area, members understand expected limitations in sharing confidential client information across areas.

It is recognized that the larger and more complex the firm, the more likely the need is for creating separate areas of practice.

Limited access to files. Much of the information obtained throughout the course of an engagement is retained in the files of the firm—either electronically or paper-based. To maintain the confidentiality of these files, a firm may put in place a formal system that:

- limits access to these files to persons who are working directly on the engagement;
- logs access to files; and
- documents any access exceptions.

The physical segregation of particular confidential information may further enhance its protection.

Use of Employee Confidentiality Agreements. The use of blanket or engagement-specific confidentiality agreements signed by employees to emphasize the need for confidentiality would be a further step in protecting confidential information.

Engagement Code Names. In areas of practice where the likelihood of conflicts of interest arise on a regular basis, the use of code names or numbers will often assist in using Chinese Walls and other tools to manage conflicts.

1. Choose the Institutional Mechanisms (continued)

B) Chinese Walls

Chinese Walls are formal procedures put in place by a firm to restrict information flows between units or individuals within the firm who are likely to receive confidential information. The purpose of Chinese Walls is to ensure confidential information is not communicated, inadvertently or otherwise, between units or individuals within a firm who should not be privy to such information.

When working “behind” a Chinese Wall, the CA is unaware of...

- other information obtained by firm members; and
- competing interests of clients served by other firm members.

Clearly, the CA will not be influenced by the existence of information not known to him or her. The problem remains, however, that even the appearance of the conflict may cause harm. An effective conflict management process should effectively counter all conflicts—real or perceived.

Maximizing the Effectiveness of Chinese Walls

To improve the overall use of the Chinese Walls, firms should...

Designate an “Above the Wall” Person to monitor the activities within the Chinese Wall(s) and to ensure that the firm as a whole is not acting in an inappropriate manner. This person would...

- ensure that the firm did not engage in activities that it was not appropriate or possible to manage;
- ensure that persons joining or leaving a team do not create new unacceptable conflicts;
- document the team's respect for the wall; and
- avoid involvement in or detailed knowledge of information contained within the wall.

Heed the Skepticism of the Courts, particularly the Supreme Court of Canada's expressed skepticism about the effectiveness of Chinese Walls. Chinese Walls should involve some combination of the following organizational arrangements:

- physical separation of the various departments in order to insulate them from each other. This often extends to such matters of detail as dining arrangements;
- an educational program, normally recurring, to emphasize the importance of not improperly or inadvertently divulging confidential information;
- strict and carefully defined procedures for dealing with a situation where it is felt that the wall should be crossed and maintaining proper records where this occurs;
- monitoring by compliance officers of the effectiveness of the wall; and
- disciplinary sanctions where there has been a breach of the wall.

C) Cones of Silence

A Cone of Silence is achieved by means of a solemn written undertaking by a CA not to disclose specific confidential information. Cones of Silence may be used to...

- demonstrate foresight of the need to maintain client confidentiality and thereby assist a firm to manage conflicts arising in various areas of its practice;
- allow a firm specialist to work on a minor aspect of an engagement, without bringing him/her formally within a Chinese Wall; and
- demonstrate the commitment of those involved.

In rare circumstances, a Cone of Silence is demonstrated implicitly by the special conduct of a CA. In such circumstances, there should be observable evidence that the Cone of Silence will be effective.

Limitations of Institutional Mechanisms

The limitations on the use of firm structure, Chinese Walls and Cones of Silence must always be recognized and considered in terms of whether the firm's fiduciary duty can be fulfilled. A professional judgment must be made in light of the particular facts and circumstances. To the extent that confidential client information has already been shared within a firm, it may be too late for institutional mechanisms to be effective. The presumption is that ongoing institutional mechanisms used on a regular basis are more effective than those set up on an ad hoc basis. The particular limitations of Chinese Walls are discussed further below.

The uses of institutional mechanisms to restrict information flows between units or individuals within a firm may not be effective in circumstances that include...

- not always being able to satisfy the fiduciary duties the firm owes to its client. For example, a client who expects to have access to all of the firm's resources and does not because the use of a Chinese Wall is protecting the interest of another client.
- not being accepted by the courts as effectively preventing members of a firm from sharing confidences with each other. It must be structured to clearly demonstrate that the Chinese Wall will be, or has been, highly effective in this regard.
- The courts have expressed a higher degree of skepticism concerning the effectiveness of Chinese Walls within the following organizational structures...
 - a single department or operating unit; or
 - a large number of people coupled with a high turnover rate within the wall.
- "Hiding behind the wall"; a CA may be aware that a possible conflict exists, but decides against making the appropriate enquiries and professional judgments. Instead, the CA chooses to ignore the conflict altogether, hiding behind the guise that the Chinese Wall will protect confidential client information.

2. Provide Disclosure and Obtain Client Consent

A fundamental underpinning to the management of conflicts of interest involves “informed consent” by clients. Unless the conflict is one that is commonly known and generally accepted, “informed consent” should be obtained by...

- notifying the client of the conflict; and
- either declining or resigning the engagement, or obtaining agreement from the client to proceed in spite of the conflict.

The appropriateness of managing a particular conflict is likely to depend on particular facts in particular circumstances. As circumstances evolve, clients who initially agreed to allow a firm to act with a conflict may change their position and the risk and consequences of this should be considered when making the decision.

When a CA enters into discussions with a client about the impact of possible conflicts on the client's interest, the CA is expected to do so in a professional manner. Any resulting duty to the client should not be unreasonably restricted as a result of the contract.

How?

It appears that the courts will recognize the contractual clarification of fiduciary duties by either express or implied terms. A CA firm may clarify fiduciary duty through contractual terms using disclosure and consent.

A CA may clarify fiduciary duty by...

Writing an Engagement Letter or Contract

An engagement letter may be used to clarify fiduciary duty. The following wording might be used to inform a client of restrictions to an engagement (other than an audit engagement) where a firm uses institutional mechanisms to protect confidential client information:

“It is the practice of the firm to protect confidential client information through the use of institutional mechanisms and by restricting the internal sharing of information to those working on the engagement. As a result of work undertaken for other clients whose interests may conflict with yours, certain firm resources may not be available to you.”

Similar language may be used in contracts.

Making a Public Policy Statement or Similar Contract Language

Written expression in public policy statements of clarifications to fiduciary duty also appear to be a tool which firms can use to manage possible conflicts of interest.

Including Fiduciary Duties in Final Reports or Proposals

To the extent that the matter is not dealt with in the foregoing, clarifications of fiduciary duty may also be included in final reports, proposals.

What?

In the engagement letter, public policy statement or contract, the fiduciary relationship may be clarified by...

Defining Duties

Clearly defining the fiduciary duties owed to the other party. This may be accomplished through an exclusion clause; and

Setting Limits

The contract should clearly delineate the rights and duties of all parties.

Making Termination Provisions

Where management of a conflict is done in part by a client's “informed consent”; include provisions that set out the consequences should the client terminate their consent. It might be agreed, for example, that in such circumstances the CA would (or would not) be able to continue to act for one of the other parties—and if so, which one.

Step 4: Assess the Effectiveness of a Conflict Management Plan

After choosing the institutional mechanisms (conflict management techniques) that the CA will be using or relying upon in his or her Conflict Management Plan, the CA needs to review the overall plan to see if the plan will work in practice. Remember, the onus will be on the CA to demonstrate to the courts that the institutional mechanisms were effective in protecting confidential client information.

When assessing the effectiveness of the selected institutional mechanisms, the CA should ask the following questions...

1. How effective will the institutional mechanisms be?
2. Will the institutional mechanism work in practice? For example, it may not be possible to obtain the "informed consent" of two clients as the mere disclosure of the issue to one client would alert the other client to confidential information.
3. Are the persons required to perform the work able to remain within any Cone of Silence or Chinese Wall for the required period of time?

Step 5: Re-evaluate the Plan During Engagement

Often, client relationships span an extended period of time. Over time, it is likely that client interests may change. When in the course of pursuing an engagement for a client, substantive conflict or possible conflict with an engagement for another client is discovered, a firm should consider the following alternatives:

- resign from both assignments
 - (a) without disclosure of the detailed reasons if such disclosure would betray confidential client information; or
 - (b) with appropriate disclosure of the detailed reasons, if confidential client information can be protected in so doing.
- obtain "informed consent" from both clients to continue their engagements in spite of the conflicts.
- seek permission from both sides to continue for one side, and to use appropriate institutional mechanisms to protect confidential client information.
- after obtaining the required consent in (b) or (c), use institutional mechanisms such as Cones of Silence or Chinese Walls, to protect confidential client information in appropriate circumstances.

There are a number of conditions that may affect a firm's ability to choose amongst the above alternatives. Because the discovery of the conflict has occurred while the engagement is in progress, it is likely more difficult to utilize institutional mechanisms to protect confidential client information. It is also difficult to clarify the firm's fiduciary duty by indicating that the firm intends to accept engagements for clients whose interests may from time to time conflict with existing clients, or that because of the variety of interests of the firm's clients, client interests may from time to time conflict, and that the firm will use institutional mechanisms such as Cones of Silence or Chinese Walls to protect confidential client information.

On the other hand, if institutional mechanisms such as Cones of Silence or Chinese Walls have been in place from the outset of both client assignments, or clients have been informed at the outset of possible conflicts, the task of dealing with new conflicts which arise is made easier.

Task Force Observation

In those areas of practice where relationships extend for a year or more, the issue of potential conflicts should be revisited in the Client Continuance Review to provide continued assurance that no conflicts exist.

Recommendations

The issue of addressing conflicting client interests is a serious issue for CAs and their firms. The Task Force believes that changes by the provincial institutes/ordre to the rules of professional conduct are required to clarify the responsibility of the profession to the public and to enable CAs to continue using their professional judgment in choosing how to fulfill their fiduciary duty including maintaining confidential client information. The Task Force recommends that...

1. the rules of professional conduct be changed to explicitly recognize fiduciary duty and to restrict the flow of confidential information within a CA firm to a "need to know" basis (i.e., only those persons in the firm who are working on a specific matter where confidential client information is involved should have access to such information. All persons inside a firm who obtain confidential client information should be required to protect that information).
2. the rules of professional conduct be changed to require a CA firm that is engaged on a matter where the interests of two or more clients conflict decline to act for one or more of the clients or potential clients unless it...
 - obtains the "informed consent" of the clients or potential clients in utilizing institutional mechanisms to fulfill its fiduciary duties to those clients; or
 - is able to clearly support its reliance on and use of institutional mechanisms on the basis of generally accepted usage in situations where no specific term of a contract with a client is being breached.
3. CA firms adopt a framework and a process for dealing with client conflicts of interest. The framework should:
 - recognize the role of professional judgment in this process; and
 - require CA firms to demonstrate that the interests of their clients will be served at a high professional standard.
4. the appropriate professional standard is one that protects confidential client information and ensures the fulfillment of the CA firm's duty of loyalty.
5. a standard that allows the use of institutional mechanisms is reasonable, appropriate and should be implemented. Specifically, the use of Chinese Walls to restrain the internal flow of confidential client information from one person in a CA firm to another is reasonable.
6. in order to assist CAs in the exercise of professional judgment when dealing with the need to avoid conflicts or to manage them using particular techniques, the provincial institutes/ordre provide advice on this subject through their practice advisory service.
7. the provincial institutes/ordre include within their practice inspection program a review of a CA's firm's conflict of interest policies, together with an assessment of their effectiveness.

Glossary

Above the Wall

A Partner of the Firm who is involved in an engagement such that he or she has access to information held by the Firm received by different parties is considered to be "Above the Wall". Clients could see this as a conflict. These individuals cannot rely on the procedural safeguards of the "Chinese Wall" and, therefore, need to be particularly careful to avoid any improper use or dissemination of non-public information. *Thus, in virtually all cases, a partner "Above the Wall" will be precluded from participating on any team working on a specific engagement.*

However such a partner could play a senior management role if conflicts, such as use of confidential information, are properly managed.

Chinese Wall

Procedures designed to restrict flows of information within the Firm from units or individuals who are likely to receive confidential information to ensure that it is not improperly communicated, inadvertently or otherwise, to other units or individuals. The Wall normally involves some combination of:

- physical separation of the various departments and their paper and electronic files;
- an educational program to emphasize the need to not improperly divulge confidential information;
- strict and carefully defined procedures for dealing with a situation where the Wall is crossed;
- monitoring by compliance officers of the effectiveness of the Wall; and
- disciplinary sanctions where there has been an improper breach of the Wall.

Cone of Silence

A "Cone of Silence" is achieved by means of a solemn formal undertaking not to disclose by the affected person. In some circumstances, a "Cone of Silence" is achieved implicitly by special conduct of a person. In such circumstances, there should be observable evidence that the "Cone of Silence" will be effective. Cones of Silence may be used to demonstrate foresight of the need to maintain client confidentiality and thereby assist a firm to manage conflicts arising in various areas of its practice.

Confidential Client Information

Confidential client information refers to information which is not in the public domain and which would not normally be released by the client. The sensitivity of confidential client information is often reduced by the passage of time and is not easily defined since the impact of disclosing information is not always clear.

Documentation

A documented chronological record of basic engagement information including the names of persons who were involved in the engagement and at what date. This information may be required to facilitate a post review of the engagement.

Fiduciary

A fiduciary duty is, under the law, a trust relationship in which a person undertakes to act on behalf of or for the benefit of another, often as an intermediary with discretionary powers.

Informed Consent

Consent granted by one who has a full understanding of what is involved.

"Need to Know" Basis

The flow of confidential client information inside a firm is restricted to those members who require the information to pursue the client's interest.

Rebuttable Presumption

A presumption which may be rebutted by evidence.

Silo

A concept used to ensure that confidential client information is only disclosed to those who have a "need to know" for business purposes. A silo may exist even within a sensitive practice area. In most cases, there will be a "Cone of Silence" around the employees working within the silo.

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Legal Analysis of Fiduciary Duty

Robert D. Peck, Barrister and Solicitor

Accountants and accounting firms owe a duty to their clients to defend and advance their interests. This duty, a fiduciary duty, is more extensive than the fiduciary duty of confidentiality. As accounting firms often act for several clients in the same or related fields of business, and the interests of the clients may conflict—the accounting firm may find itself in a position of conflict—and face the prospect that a court...

- will almost certainly preclude the accounting firm from acting against the interests of an existing client to which it owes a duty of undivided loyalty; and,
- may preclude an accounting firm from acting against a former client, if their relationship was sufficiently related to a proposed new engagement to pose a risk to the former client's interest on account of the information the client confided to the firm.

Courts have granted injunctions which have precluded accounting firms from accepting or completing a forensic engagement against both a former and current client. The issue for the accounting profession is whether the courts will apply the same duty of undivided loyalty, and be as skeptical about the accounting firm's plans to safeguard confidentiality, for other engagements, including audits, consultations, tax and mergers and acquisitions.

Fiduciary duties arise from and are defined by the relationship of the accountant and the client. Professional standards and widely accepted practices may be considered part of the relationship which defines these duties. Accordingly, the accounting profession and the accounting firms, large and small, have a vital interest in reviewing the professional standards and practices designed to safeguard confidentiality and preclude disqualifying conflicts of interest.

This appendix is intended to provide the reader, including those advising governing bodies and accounting firms, with some of the basic legal background which gave rise to a Task Force which has sought to address the issue of how the profession deals with conflicts between clients.

The fiduciary duties which preclude an accountant from putting himself in a position of conflict with his client or profiting at a client's expense remain fundamentally important and apply with all clients. This analysis focuses on the accountant's fiduciary duties of confidentiality and undivided loyalty, duties to clients which are complicated by the fact the accountant [the firm] has similar duties to other clients. The last research for relevant cases was conducted in early September, 2000.

This legal analysis of fiduciary duty is outlined in the following three parts...

PART 1: An overview of the relevant points.

PART 2: The duties, inferences and implications. Excerpts from authoritative and relevant cases which make it clear conflicts are not of academic interest only as courts grant injunctions to preserve fiduciary duties which a chartered accountant, or firm of chartered accountants owe the client.

PART 3: The "Conflict Rules" of the accounting profession in Canada and the legal profession in Ontario.

PART 1: An Overview

1. Accountants are under increasing scrutiny with respect to conflicts of interest, including how they handle conflicts between clients, or a former client and a current client. If a client, or former client, perceives a risk to their interest because of a conflicting interest of another client and asks the court to protect its interest, the accounting firm is not permitted to disclose the specific information received from the client in an attempt to show there is no risk. The only evidence acceptable to the court, to establish that a duty of confidentiality or a duty not to act adversely to an existing client's interest is not at risk, is institutional in nature. The professional standards and firm practices can be referred to but there can be no reference to the specific information confided by the client.
.....
2. Once a client shows a previous relationship with the accountant which is sufficiently related to the retainer being questioned [the accountant's proposed new engagement] it is assumed the accountant has received confidential information which could prejudice the client.
.....
3. The courts have held there is a strong inference that partners share the confidences their clients have entrusted to them. There is a presumption the knowledge of one partner is the knowledge of all partners. This assumption of imputed knowledge may be quite different from the reality, particularly when the culture of the profession and practices of accounting firms is that information is often shared only on a "need to know" basis.
.....
4. Courts are skeptical about a "need to know" culture and the effectiveness of institutional mechanisms designed to preserve confidentiality. The Supreme Court of Canada has explicitly said that such mechanisms as Chinese Walls and Cones of Silence cannot be relied upon by lawyers [professionals] until the governing bodies have studied them and determined that they will satisfy the need to maintain the integrity of the profession.
.....
5. The undivided loyalty rule requires a firm to act in the client's interest and courts are not reluctant to preclude a firm from acting against the client's interest.
.....
6. In two cases where an accounting firm has proposed to accept or undertaken a forensic accounting engagement against a client or former client, the courts have held that the accountant owes the same duty as a solicitor owes to a client or former client; and, the courts have granted an injunction preventing the firm from accepting or completing the engagement.
.....
7. The professional standards of the accounting profession and practices of the firms reflect the fact that clients often choose accountants for their knowledge of a particular field, knowledge usually gained by acting for other clients in the field. The conflict of interest rules of the accounting profession, in contrast to the rules of the legal profession, permit the accountant to accept such engagements and do not explicitly address the undivided loyalty rule.
.....
8. One court has acknowledged that some clients do consent, or as a result of widely known and accepted practices may be taken to consent, to their auditor acting for another client with an adverse interest. Whether the courts will imply or recognize a similar consent with respect to consulting and other engagements is not known.
.....
9. While it is clear a former client must show a relationship which is sufficiently related to the proposed engagement in order to establish a risk their interest will be prejudiced on account of the confidential information the firm has received, an existing client is owed a duty of confidentiality and a duty of undivided loyalty. A firm that accepts, or proposes to accept, an engagement must be sure the duty of loyalty to that client will not breach its duty of loyalty to another client.
.....
10. As the legal and equitable duties the courts will impose are tailored to the legal and practical incidence of the relationship, the professional standards and practices which safeguard confidentiality and stipulate how to deal with possible conflicts of interest, and the acceptance of such practices and standards by clients may be very relevant in future cases.

PART 2: Duties, Inferences and Implications

Duties

Fiduciary Duties Created and Defined by the Relationship

The duty which an accountant has to a client arises from the relationship with the client. This duty is called a fiduciary duty and the Supreme Court of Canada has said of such duties:

“In summary, the precise legal or equitable duties the law will enforce in a given relationship are tailored to the legal and practical incidents of a particular relationship.” To repeat a phrase used by Lord Scarman, “[t]here is no substitute in this branch of the law for a meticulous examination of the facts”: see *National Westminster Bank plc v. Morgan*, [1985] 1 All E.R. 821 (H.L.) at page 831.”¹

The accounting firm and client are free to contractually define the specific duties and often the engagement letter is used to do so. But the engagement letter may not always fully define [limit] the fiduciary duties.

The Law Commission in the United Kingdom considered the effect of statutory and self-regulatory controls on the fiduciary duties of professionals.² It summarized the fiduciary duties under four basic rules.

1. The “No Conflict” Rule

A fiduciary must not place himself or herself in a position where his or her own interest conflicts with that of his or her client, the beneficiary.

2. The “No Profit” Rule

A fiduciary must not profit from his or her position at the expense of his or her client, the beneficiary.

3. The Undivided Loyalty Rule

A fiduciary must not act at the same time both for and against the same client. A consequence of his or her duty is that a fiduciary must make available to a client all the information that is relevant to the client's affairs.

4. The Duty of Confidentiality

A fiduciary must only use information obtained in confidence from his or her client, the beneficiary, for the benefit of the client and must not use it for his or her own advantage, or for the benefit of any other person.

The “no conflict” and “no profit” rule apply to the accountant's relationship with each client. These fiduciary duties are reflected in the objectivity and independence requirements of the profession and in the rule which precludes unauthorized benefits.

The undivided loyalty rule and the duty of confidentiality apply to each client and a potential problem arises for the accounting firm because the interest of one or more clients may conflict.

Judicial Enforcement

It is these duties, the duty of confidentiality and the duty of undivided loyalty [the duty not to act at the same time both for and against the same client] have been the basis on which courts have granted injunctions.^{3,4,5}

In both cases, the courts at the insistence of an original client have examined the facts of a relationship and granted an injunction to preclude an accounting firm from accepting a forensic engagement, in one instance, and completing a forensic engagement in the other instance, for a “subsequent client” adverse in interest to the original client.

One of the two cases, *Bolkiah v. KPMG*, is a decision of the House of Lords, England's highest court. This decision is final and determinative of the issue in that case. While it is not binding on courts in Canada it has been and will be very influential. In the other case, *Drabinsky v. KPMG*, a judge of the Ontario Superior Court, in Motions Court, granted an interlocutory injunction. KPMG's appeal was dismissed by the Divisional Court.

Both courts imposed on the accounting firm the same duty as would have been imposed on a solicitor. The courts were aware the applicable rules of professional conduct were different.

The *Drabinsky v. KPMG* action has since been settled. While the actual duty of an accountant who has undertaken a forensic engagement has not been definitively settled in Canada, given the decision in *Bolkiah* and the dismissal of the appeal in *Drabinsky*, the profession should expect that the court will hold a forensic accountant to the same duty as the court holds a solicitor.

¹ *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 [LaForest J. for the court at p. 400]

² Fiduciary Duties and Regulatory Rules – The Law Commission [UK] December 1995, p. 2

³ *Drabinsky v. KPMG*, [1999] 41 O.R. (3d) 565

⁴ *Drabinsky v. KPMG*, (unreported, Ontario Superior Court of Justice, Divisional Court, Justices, O'Leary, Keenan and Lederman on appeal from the decision of Ground J., April 30, 1999) [1999 O.J. No. 1416]

⁵ *Bolkiah v. KPMG*, [1999] 2 A.C. 222

Duties to Existing Client More Comprehensive Than Duties to Former Client

The decision of the House of Lords, in *Bolkiah*, made it clear that the duty to an existing client is more comprehensive than the duty to a former client. The duty to an existing client includes both the duty of confidentiality and the duty of undivided loyalty. The duty to a former client is the duty of confidentiality.

This distinction was made clear when the court discussed the different basis for intervention on behalf of an existing client and a former client. The relevant paragraphs are set out opposite.

NOTE:

As with other quotes in this appendix, the bold print indicates emphasis added.

■ Duties to Existing Client

“... It is otherwise where the court's intervention is sought by an existing client, **for a fiduciary cannot act at the same time both for and against the same client, and his firm is in no better position. A man cannot without the consent of both clients act for one client while his partner is acting for another in the opposite interest.** His disqualification has nothing to do with the confidentiality of client information. It is based on the inescapable conflict of interest which is inherent in the situation.

This is not to say that such consent is not sometimes forthcoming, or that in some situations it may not be inferred. There is a clear distinction between the position of a solicitor and an auditor. **The large accountancy firms commonly carry out the audit of clients who are in competition with one another. The identity of their audit clients is publicly acknowledged. Their clients are taken to consent to their auditors acting for competing clients, though they must of course keep confidential the information obtained from their respective clients.**

This was the basis on which the Privy Council decided *Kelly v. Cooper* [1992] A.C. 205 in relation to estate agents.”

■ Duties to Former Client

“Where the court's intervention is sought by a former client, however, the position is entirely different. The court's jurisdiction cannot be based on any conflict of interest, real or perceived, for there is none. The fiduciary relationship which subsists between solicitor and client comes to an end with the termination of the retainer. Thereafter the solicitor has no obligation to defend and advance the interests of his former client. The only duty to the former client which survives the termination of the client relationship is a continuing duty to preserve the confidentiality of information imparted during its subsistence.”

Bolkiah v. KPMG, supra, per Lord Millett at p. 234 H to p. 235 D.

PART 2: Duties, Inferences and Implications (cont'd)

Duties (cont'd)

Existing Client When New Engagement Accepted

In the Ontario case involving Garth Drabinsky and KPMG, when KPMG undertook a forensic engagement designed to gather evidence against Garth Drabinsky, he was an existing client of KPMG. In upholding the injunction granted by the motions court judge, which precluded not only the disclosure of confidential information the firm may have received from Drabinsky but also the disclosure of information directly adverse to the interest of Garth Drabinsky obtained in their investigation of him, the Divisional Court said:

“In the circumstances of this case, the Motions Judge found that **the duties imposed on KPMG extended beyond the duty not to disclose confidential information and included a duty of loyalty and good faith and a duty not to act against the interests of the client.** The combination of the following circumstances is of particular importance:

- (1) Garth Drabinsky was an existing and long-standing client of KPMG, who were his personal accountants and tax advisors and as such, KPMG had acquired and had an intimate knowledge of his financial affairs; and
- (2) KPMG was not Livent's auditors and had no on-going relationship with Livent, but was now asked to conduct a wide-ranging forensic investigation into suspected irregularities with Garth Drabinsky as the main target.”

Drabinsky v. KPMG, Divisional Court, supra para. 3.

“The *House of Lords in Prince Jefri Bolkiah v. KPMG*, [1999] 1 All E.R. 517 makes a clear distinction between the duties owed by an accounting firm requested to perform forensic work adverse in interest to an existing as opposed to a former client. At page 526, Lord Millett states that with respect to existing clients,

“... a fiduciary cannot act at the same time both for and against the same client... His disqualification has nothing to do with the confidentiality of client information. It is based on the inescapable conflict of interest which is inherent in the situation.”

Drabinsky v. KPMG, Divisional Court, supra para. 4.

While the Ontario Divisional Court did refer to the decision in *Bolkiah* above, it was less definitive about the auditor's fiduciary duty being narrower than the duty of a forensic accountant.

“**Although in other circumstances** (where, for example, the client in question is a former client, or where the accounting firm is engaged as the company's auditors), **the fiduciary duty owed to the client may be narrower and may be limited to a duty to preserve confidentiality only**, in the unique circumstances of this case, there is a reasonable basis to believe that the duty may be sufficiently broad to prohibit KPMG from taking on the forensic mandate from Livent which would be directly adverse to the interests of Garth Drabinsky, its on-going client. Thus, the scope of the duty and whether there has been a breach are serious issues to be tried and the Motions Judge did not err in this respect.”

Drabinsky v. KPMG, Divisional Court, supra para. 5.

The Standard to be Applied?

Audit, Forensic, Consulting and Other Engagements

The statements highlighted above make it clear that the fiduciary duty of an auditor is unlikely to preclude the auditor from acting as the auditor for other clients in the same or related fields of business. Moreover, it may be that other clients may be taken to acknowledge that the accounting firm's duty to an audit client may limit the duty owed to them. But, as pointed out, this does not appear to be certain in Ontario (Canada).

With respect to forensic engagements, it does seem certain, the duty a court will impose on an accounting firm is the same duty it will impose on a solicitor. In *Bolkiah* the House of Lords made the point that much of the work proposed to be done as a forensic engagement was similar to work customarily done by solicitors.

At this time there have not been cases where a court has granted an injunction to preclude a proposed engagement for other services including consulting, mergers and acquisitions or tax.

As it is clear the legal and equitable duties imposed by the court are tailored to the legal and practical instances of the relationships [see *Hodgkinson*, supra], the standards of the profession, the practices of the firms, and the standards and practices accepted by clients could be highly relevant when a court determines which duty will apply and in particular the extent of the undivided loyalty rule in such cases. Among the concepts which could be challenged is the concept that it is possible to satisfy the duty of loyalty to a client with respect to a particular engagement when a different office of the firm is providing services to a competing client.

It should be expected that an analysis similar to the analysis made in *Bolkiah*, which inter alia, compared the standards of another profession which provided such services, will be made by the courts in the future. When and if the duty of undivided loyalty with respect to audit and consulting clients, is considered by an authoritative appellate court, the court will likely engage in a wide ranging policy review, as the Supreme Court of Canada did in the case of *MacDonald Estate v. Martin*⁶.

⁶ *MacDonald Estate v. Martin*, [1990] 3 S.C.R. 1235 [Sopinka J. for the court].

PART 2: Duties, Inferences and Implications (cont'd)

Inferences

Firms – Imputed Knowledge and Confidential Information

In reviewing the professional standards and practices designed to safeguard confidentiality and preclude disqualifying conflicts of interest, the profession and particularly its governing bodies must be aware the duty is owed by the firm, all of the partners and professionals of the firm, to the client or former client.

While the duty to an existing client includes a duty to advance the best interests of the client, and the duty to a former client is the less onerous duty to preserve the confidentiality of information disclosed during the accountant-client relationship, this is still an onerous duty. Further the courts infer that the partners share the confidences of their clients. While only institutional mechanisms designed to preclude sharing of confidences are permitted into evidence by the court to rebut the inferences, the courts are skeptical about such institutional mechanisms.

The Supreme Court of Canada in the *MacDonald Estate* case definitively set out the two inferences [assumptions] and laid down a challenge for governing bodies.

The factual situation in the *MacDonald Estate* case was relatively simple. A young lawyer in one firm joined another firm. A client of the former firm challenged the right of the new firm to continue to act as counsel in an action against him as the lawyer who had joined the firm had confidential information which it was alleged would prejudice the client.

The Supreme Court of Canada held that there were two fundamental questions which had to be addressed:

1. Did the lawyer receive confidential information attributable to a solicitor and client relationship relevant to the matter at hand? and
2. Is there a risk that it [the confidential information] will be used to the prejudice of the client?

The Inference Confidential Information Was Imparted

With respect to this first question the Court established the principle that if the retainers are sufficiently related there is a presumption that confidential information has been imparted. Further, the Court imposed a stringent test on those who try to establish that confidential information has not been imparted. Speaking for the majority of the Court, Justice Sopinka said:

“... once it is shown by the client that there existed a **previous relationship which is sufficiently related to the retainer** from which it is sought to remove the solicitor, **the court should infer that confidential information was imparted unless the solicitor satisfied the court that no information was imparted which could be relevant.** This will be a difficult burden to discharge. Not only must the court's degree of satisfaction be such that it would withstand the scrutiny of the reasonably informed member of the public that no such information passed, but the burden must be discharged without revealing the specifics of the privileged communication. Nonetheless, I am of the opinion that the door should not be shut completely on a solicitor who wishes to discharge this heavy burden.”

MacDonald Estate v. Martin, supra at para. 55

The Inference Confidential Information Has Been Shared

With respect to the second question, whether or not there is a risk of prejudice to the client because confidential information has been shared with other partners, the majority of the Supreme Court of Canada rejected the conclusive “imputed knowledge test” which has been accepted in the United States.

The American principle, that once a substantial relationship is established there is an irrefutable presumption that confidential information will be shared, was rejected as too rigid as it failed to take into account the relevant interests which include:

- The client's right to services of the professional of his choice,
- The professional's right to offer services to the public generally,
- Mobility within the profession by individuals of firms merging,
- The interest firms had in merging,
- Access to expertise and special services; and
- Market competition.

However, the Supreme Court made it clear there was a presumption that lawyers [and accountants] who work together do share the confidences of their clients and they [the professionals] have the onus of satisfying the Court that there will be no disclosure of that information.

In particular, the Supreme Court of Canada said:

“Moreover, I am not convinced that a reasonable member of the public would necessarily conclude that confidences are likely to be disclosed in every case despite institutional efforts to prevent it. **There is however, a strong inference that lawyers who work together share confidences. In answering this question, the court should therefore draw the inference, unless satisfied on the basis of clear and convincing evidence, that all reasonable measures have been taken to ensure that no disclosure will occur by the ‘tainted’ lawyer to the member of members of the firm who are engaged against the former client.** Such reasonable measures would include institutional mechanisms such as Chinese Walls and Cones of Silence. The concepts are not familiar to Canadian courts and indeed do not seem to have been adopted by the governing bodies of the legal profession.”

MacDonald Estate v. Martin, supra at para. 58.

PART 2: Duties, Inferences and Implications (cont'd)

Implications

This onus on the firm [or accountant], an onus which is relatively easy for a client or former client to have imposed, is not easily satisfied.

Sufficiently Related Matter – A Limited Limitation

In the case of a former client, it is only where their relationship [the past engagement] is sufficiently related to a proposed engagement that a court will find there is a risk to the client's interest because of a possible breach of confidentiality.

But, the profession should not expect the courts to be overly cautious about a client's assertion that the accountant was consulted on a related matter. As is clear from *Drabinsky*, the terms "personal accountants" and "tax advisors" are not given restrictive meanings.

Cases involving forensic accounting services, where the objective of the new engagement is to "uncover" wrongdoing or liability of a former client, are unlikely to result in a restricted definition of "sufficiently related matter."

This may not be the case with respect to other services provided by accounting firms where the confidential information received quickly becomes outdated. Risk of prejudice to the client's interest would seem to diminish rapidly as the confidential information becomes irrelevant. This will be a comfort for both clients and accounting firms and presumably is one of the reasons the courts have not been asked to enjoin accounting firms who were engaged to provide consulting services.

In the case of an existing client, the fiduciary duty which the accounting firm must preserve relates both to the confidential information received from the client and the undivided loyalty it owes the client. Thus the limitation that the matter be sufficiently related may be of little assistance vis-à-vis an existing client.

The clearer the professional standards are and the wider the acceptance of those practices, by clients, firms, the profession and the public, the more likely such standards and practices will be included in the legal and practical incidents the courts consider part of the accountant-client relationship which define the duty—including the duty of undivided loyalty—the accountant and accounting firm owe the client.

Challenge for the Governing Bodies

With respect to the institutional mechanisms, which are the only mechanisms available to satisfy the Court that no confidential information will be imparted, the Supreme Court of Canada said:

"Although I am not prepared to say that a court should never accept these devices [Chinese Walls] as sufficient evidence of effective screening until the governing bodies have approved of them and adopted rules with respect to their operation, I would not foresee a court doing so except in exceptional circumstances. **Thus, in the vast majority of cases, the courts are unlikely to accept the effectiveness of these devices until the profession, through its governing body, has studied the matter and determined whether there are institutional guarantees that will satisfy the need to maintain confidence in the integrity of the profession.** In this regard, it must be borne in mind that the legal profession is a self-governing profession. The Legislature has entrusted to it and not to the court the responsibility of developing standards."

MacDonald Estate v. Martin, *supra* at para. 58.

The Court's Skepticism of Institutional Mechanisms

This skepticism has implications for the profession, governing bodies and firms, large and small. The professional standards and practices will have to be seen to be adequate to protect the client's interest and maintain public confidence in the integrity of the profession.

The reluctance of the Supreme Court of Canada to accept institutional mechanisms to preserve confidentiality is reflected in *Bolkiah* and in another recent English case.

In *Bolkiah*, the House of Lords rejected a Chinese Wall as an adequate means of preserving confidentiality.

"The Chinese Walls which feature in the present case, however, were established *ad hoc* and were erected within a single department. When the number of personnel involved is taken into account, Gemma each had a rotating membership, involving far more personnel than were working on the project at any one time, so that individuals may have joined from and returned to other projects, the difficulty of enforcing confidentiality or preventing the unwitting disclosure of information is very great. It is one thing, for example, to separate the insolvency, audit, taxation and forensic departments from one another and erect Chinese Walls between them. Such departments often work from different offices and there may be relatively little movement of personnel between them. But it is quite another to attempt to place an information barrier between members all of whom are drawn from the same department and have been accustomed to work with each other. I would expect this to be particularly difficult where the department concerned is engaged in the provision of litigation support services, and there is evidence to confirm this. Forensic accountancy is said to be an area in which new and unusual problems frequently arise and partners and managers are accustomed to share information and expertise. Furthermore, there is evidence that physical segregation is not necessarily adequate, especially where it is erected within a single department."

Bolkiah v. KPMG, *supra*, per Lord Millett at p. 239 para. A to D.

In *Young v. Robson Rhodes*⁷, Mr. Justice Laddie of the The High Court of Justice, Chancery Division, England heard an application for an injunction to prevent two accounting firms from merging. A partner in one firm had accepted a forensic engagement with respect to the alleged negligence of and losses caused by a firm with which his firm subsequently proposed to merge.

Courts seldom grant an injunction which requires a party to provide services to another party. In the case, in part because much work had been done, it was proposed that the engagement be completed under conditions which would appropriately isolate the engaged partner and his team from the rest of the merged firm. Mr. Justice Laddie allowed the merger to proceed but the information barrier (Chinese Wall) he designed, in effect, completely segregated the engaged accountant and his team from the rest of the firm.

In these matters, accounting firms should not expect a sympathetic court.

⁷ *Young v. Robson Rhodes* (a firm), [1999] 3 All E.R. 524

PART 3: Conflict Rules of the Accounting & Legal Professions

It is clear from a review of the current rules that the conflict rules for lawyers are very different from the conflict rules for chartered accountants.

Chartered Accountants

The Rule of Professional Conduct which deals with possible conflicts of interests, Rule 207, reads:

“Informing clients and associates of possible conflicts of interest.

A member engaged in the practice of public accounting or the public practice of a function not inconsistent with public accounting shall inform his or her clients or associates in such practice of any business connections, any affiliations, and any interests of which they might reasonably expect to be informed but this does not necessarily include disclosure of professional services the member may be rendering or proposing to render to other clients.”

It can readily be seen the rule permits an accounting firm rendering professional services to an existing client to be asked to render, or agree to render, professional services to another client which might conflict with the interests of the original client.

There are no Council Interpretations which assist the chartered accountant to apply the rule. This is in contrast to the rules applicable to lawyers.

Lawyers

The Relevant Rule of Professional Conduct of the Law Society of Upper Canada reads:

“Conflict of Interest, Rule 5

The lawyer must not advise or represent both sides of a dispute and, save after adequate disclosure to and with the consent of the client or prospective client concerned, should not act or continue to act in a matter when there is or there is likely to be a conflicting interest.”

The commentaries, numbered paragraphs which follow the rules and set out guiding principles, make it clear that:

- The lawyer's judgment and loyalty are not to be comprised; and
- Conflicting interests are not limited to financial interests.
 - “1. A conflicting interest is one which would be likely to affect adversely the lawyer's judgment on behalf of, or loyalty to a client or prospective client, or which the lawyer might be prompted to defer to the interests of a client or prospective client.
 3. Conflicting interests include but are not limited to the financial interest of the lawyer or an associate of the lawyer, and the duties and loyalties of the lawyer to any other client, including the obligation to communicate information.”

The guiding principles also make it clear that:

- The term lawyer includes law firm; and
- With respect to former clients the law firm cannot act in the same or a related matter; nor may it act in a new matter if the law firm has confidential information which would prejudice the client.
 - “13. A lawyer who has acted for a client in a matter should not thereafter act against the client (or against persons who were involved in or associated with the client in that matter) in the same or any related matter, or when the lawyer has obtained confidential information from the other party in the course of performing professional services. It is not, however, improper for the lawyer to act against a former client in a fresh and independent matter wholly unrelated to any work the lawyer has previously done for that person, and where such confidential information is irrelevant to that matter.
 16. For the sake of clarity, the foregoing paragraphs are expressed in terms of the individual lawyer and that lawyer's client. However, it should be understood that the term “client” includes a client of the law firm of which the lawyer is a partner or associate, whether or not the lawyer handles the client's work.”

Further, the guiding principles require that the disclosure:

- Enable the client to make an informed decision; and
- Be in writing as should be the client's acknowledgement and consent.

"4. The Rule requires adequate disclosure to enable the client to make an informed decision about whether to have the lawyer act despite the presence or possibility of the conflicting interest. As important as it is to the client that the lawyer's judgment and freedom of action on the client's behalf should not be subject to other interests, duties or obligations, in practice this factor may not always be decisive. Instead it may be only one of several factors which the client will weigh when deciding whether or not to give the consent referred to in the Rule. Other factors might include, for example, the availability of another lawyer or comparable expertise and experience, the extra cost, delay and inconvenience involved in engaging another lawyer and the latter's unfamiliarity with the client and the client's affairs. In the result, the client's interests may sometimes be better served by not engaging another lawyer, for example, when the client and another party to a commercial transaction are continuing clients of the same law firm but are regularly represented by different lawyers in that firm.

5. Before the lawyer accepts employment for more than one client in a matter or transaction, the lawyer must advise the clients concerned that the lawyer has been asked to act for both or all of them, that no information received in connection with the matter from one can be treated as confidential so far as any of the others are concerned and that, if a conflict develops which cannot be resolved, the lawyer cannot continue to act for both or all of them and may have to withdraw completely. If one of such clients is a person with whom the lawyer has a continuing relationship and for whom the lawyer acts regularly, this fact should be revealed to the other or others with a recommendation that they obtain independent representation. If, following such disclosure, all parties are content that the lawyer act, the latter should obtain their written consent, or record their consent in a separate letter to each. The lawyer should, however, guard against acting for both sides where, despite the fact that all parties concerned consent, it is reasonably obvious that an issue contentious between them may arise or their interests, rights or obligations will diverge as the matter progresses."

If a contentious issue arises:

- The lawyer [law firm] may not act for either client with respect to the contentious issue or issues; unless,
- It was agreed at the outset that in the event of a conflict, the lawyer would act for one of the clients.

"6. If, after the clients involved have consented, an issue contentious between them or some of them arises, the lawyer, although not necessarily precluded from advising them on other non-contentious matters, would be in breach of the Rule if the lawyer attempted to advise them on the contentious issue. In such circumstances the lawyer should ordinarily refer the clients to other lawyers. However, if the issue is one that involves little or no legal advice, for example, a business rather than a legal question in a proposed business transaction, and the clients are sophisticated, the clients may be permitted to settle the issue by direct negotiation in which the lawyer does not participate. Alternatively, the lawyer may refer one client to another lawyer and continue to advise the other if it was agreed at the outset that this course would be followed in the event of a conflict arising."