



distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services....

For a member in public practice, the maintenance of objectivity and independence requires a continuing assessment of client relationships and public responsibility. Such a member who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a member should maintain objectivity and avoid conflicts of interest. (AICPA Professional Standards, ET Section 55.)

The ability to provide service with objectivity and, where required, independence is an additional requirement applicable to CPAs in evaluating professional relationships for conflicts of interest.

Conflicts of interest are addressed in the rules and regulations of boards of accountancy, regulatory agencies and professional organizations. Allegations of engaging in a conflict of interest can lead to disciplinary action, including fines, suspension and even revocation of practice privileges. Additionally, a conflict of interest is often exploited by a plaintiff's attorney in malpractice actions, regardless of whether or not the conflict caused damage to the plaintiff. While juries have difficulty following the complexities of alleged accounting malpractice claims, they readily comprehend conflicts of interest, which are frequently alleged against politicians and other public servants. When a conflict exists, it tends to adversely influence the judgement of juries regarding all facts in dispute.

Conflict Situations for CPAs

Some situations that present potential conflicts of interest are seen frequently in accounting malpractice claims. The following is a sampling:

- A CPA provides tax and financial planning advice and prepares income tax returns for a married couple. The couple initiates a divorce proceeding, and the CPA continues to provide these services to both of them as individual clients. After the divorce, the ex-wife alleges that the CPA provided tax advice to the ex-husband which caused her to pay excessive taxes in the year the divorce was finalized.
- A CPA provides tax planning, estate planning and tax return preparation services to a married couple and prepares tax returns for two of their four adult children. The CPA also agrees to serve as the trustee of a family trust established for the benefit of the four children. After the couple's death, the CPA must manage and distribute the assets of the trust (including the family business now run by one of the children) while providing tax advice for the two children who are continuing clients. The non-client trust beneficiaries allege that the CPA favored the interests of the children who were continuing clients over their interests in managing and distributing the assets of the trust.
- A CPA firm provides consulting advice to a real estate venture contemplating an acquisition while owning a small interest in this business. The firm recommends the venture as an investment to several of its other high net worth clients, but does not disclose to them that it has an ownership interest in the business. The venture fails, and one of these clients sues the CPA firm, alleging that the CPA provided negligent investment advice, had an undisclosed conflict of interest, and engaged in self-dealing.
- A CPA provides financial statement review and tax return preparation services to a manufacturing client. Another client requests that the CPA provide assistance in negotiating the purchase of real estate from the manufacturing company client. The CPA assists the purchaser in negotiating the terms of the sale, and concludes that this is not a problem because the seller is aware that the CPA represents the purchaser in the negotiations. The seller later sues the CPA firm, alleging that the CPA disclosed confidential client information

to the purchaser that was used to negotiate more favorable terms for the sale.

- A CPA provides tax planning and tax return preparation services to a partnership of doctors, and individually to one of the three partners. A dispute arises between two of the partners, leading to the decision that two of them will buy out the interests of the third. At the request of one of the two partners planning the buyout, the CPA prepares a valuation of the business to be used in setting a price. The sale is concluded. A year later, the selling partner files suit against his former partners and the CPA, alleging that the CPA had a conflict of interest and favored the interests of the other partners in preparing the valuation report.

Managing Conflict Risk

First and foremost, all firm personnel need to be vigilant in identifying relationships and situations that could be viewed by others as presenting a conflict of interest. All firm personnel should receive training on the subject. Staff professionals should be instructed to immediately bring potential conflict situations to the attention of firm management.

Avoiding potential and actual conflicts of interest requires thorough client and engagement screening procedures. Knowing your potential client is critical. Inquire about the prospective client's major business relationships, such as key clients, lenders and vendors. Determine the intended use and distribution of the your proposed workproduct. If there will be third party users, identify known users and determine if your firm has professional relationships with the users that present an actual or potential conflict. Also recognize that providing professional services to individuals employed by business clients can lead to conflicts of interest. Carefully consider this issue prior to agreeing to provide new services to these individuals.

But the process does not end there - a client's business and business relationships change over time. Evaluating client relationships for conflicts should be a continuous process, rather than one confined to an annual client continuance review.

Client Data Base

All firms should maintain a database of client information. (See **Minimum Contents of Client Data Base** below.) New clients should be added to the database when the client relationship is established. The database should be routinely updated as information changes. It can be stored electronically or in a hard copy file depending on the firm's resources and needs.

The database should be easy to use and readily available to those who need to refer to it. Any system, however, is only helpful if it is properly maintained. The firm's quality control procedures should specify the responsibility of firm personnel to transmit current information to those responsible for maintaining the database, and compliance with this requirement should be monitored.

Minimum Contents of a Client Database

- Name of client and affiliated entities, street address, web site address, telephone and facsimile numbers
- Type of client (individual, public/private company, not-for profit, employee benefit plan, trust , government entity, etc.) and SIC code
- Names of owners, senior officers and directors, including contact numbers and e-mail addresses
- Principal banking and investment banking relationships

- Names of legal counsel and other key advisors and consultants
- Major customers and vendors
- Name/office of current engagement partner and types of service provided (attest, tax, consulting, etc.)

Critical Skills

Avoiding conflicts of interest is critical to a CPA firm in order to provide quality, professional service. Being vigilant in identifying potential conflicts and remaining objective in evaluating them is key to risk management.

By John McFadden, CPA, CFE, Risk Management Consultant, CNA, Accountants Professional Liability, CNA Plaza, Chicago, IL 60685.

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