CONFLICTS OF INTEREST AND PROFESSIONALS

by Dr Paul Finn

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Introduction

By dint of circumstance I am forced to take a "lay" view on the contents of the excellent paper prepared by Dr. Paul Finn.

In todays competitive, and ever more deregulated environment the topic of conflict of interest needs to be constantly aired and brought to the attention of professional advisors.

In my opinion, ethical standards have fallen as the competitive element heats up, while at the same time the hierarchy of the professions are desperately trying to cling to past high standards of moral conduct.

Professionals today are advising clients to enter into transactions and deals of highly questionable standing, deals which would not have been contemplated by those professionals ten, or even five years ago.

As professional firms grow larger the potential for problems in the conflict of interest area increases at a geometric rate.

Also as professional firms are perceived by their partners to be more like any other profit oriented business and are managed accordingly, it becomes harder to maintain the higher ethical standards of the past. The profit motive and high ethical standards are not always totally in tune as most in depth reviews of business practice show.

Furthermore, as larger firms select progressive clients upon which to concentrate their limited resources and, target new clients for special attention, the competitive world runs into conflict with a general theme of high moral and ethical standards.

As a practical example I might add that, the standards by which professional men operate seem to change depending upon whereabouts they are located. We have as an instance in the political arena a prime example of a poacher turned game keeper and in the business arena, now we have examples of previously professional game keepers turning poachers.

Dr Finn has selected for us a number of areas falling within the general title of fiduciary relationships upon which he comments.

He has said that the problems facing the larger advisory firms, of which I have some knowledge, include :

firstly;

client conflict - that is where one has two clients on either side of the same problem. In a large professional firm one may not in fact be aware that there is a conflict. Do you know all the clients of your firm?

secondly,

the "information problem" - that is, where one gains knowledge in a confidential client dealing that my have relevance to other but separate client dealings.
The prospect of use or disclosure raises problems.

thirdly,

- the problem of "institutional interests and loyalties" - where one set of clients may be favoured to the cost of others.

Certainly, from my own point of view as a partner in a large international accounting firm, I experience all three types of problem quite often and in fact we do resort to the so called Chinese Wall as a device with which to overcome the problem.

It is commonly accepted that the basic purpose of fiduciary law is to protect the interests of a beneficiary and to require those in a fiduciary relationship to act only in the interests of that beneficiary.

In defiance of this basic axiom is the practice, quite common amongst smaller accounting firms, to take part, in a financial sense, in the activities of their clients. This, to my mind immediately brings into conflict their duty to the client as opposed to their own personal percuniary interest.

All of the major firms prohibit the holding of financial interests in clients so as to avoid this patently obvious conflict.

Dr Finn also eludes to the role that fiduciary law plays in protecting public confidence in some institutions.

This aspect is particularly relevant to the accounting profession, with the perception of auditors in our commercial society being of real concern.

It is essential for the maintenance of credibility, that the auditor not only be independent, but be seen to be independent. This proposition has caused a number of problems, especially in the United States, where there has been a perceived conflict between a firm of chartered

accountants providing both audit and management advisory services to the one client. The roles are there perceived to be mutually exclusive due to the possibility of conflict of interest.

I guess the same objection could be levelled against persons from a firm of Chartered Accountants providing both audit services and advice to client companies on accounting policy matters. Perhaps not only assisting in the process of "creative accounting" but in some cases initiating it to the chagrin of ones audit partners.

Certainly for those of us who are involved in the accounting standards setting process this does cause some degree of conflict and in some cases a feeling of uneasiness.

After dealing with the rule in the 1912 Rakusen v Ellis case and finding for the irrebutable presumption option Dr Finn turns his attention to the "consent based exceptions".

In this context, I believe that in the present commercial world a major problem arises where a director is appointed by a large corporate shareholder and then, in many cases, acts as though he is there as the representative, and only the representative, of that major shareholder. His larger directorial responsibility to the company as a whole often seems to be ignored and forgotten. This indefensible position is quite prevalent today and probably leads to a

great deal of insider trading about which we are later to hear.

Related to this issue also is the policy of some of the international accounting firms overseas to prohibit their partners from accepting directorships so as to avoid being tainted with commercialisim.

In my opinion New Zealand is far too small a place for such policies to be realistic and indeed I believe that professional accountants can gain tremendously from having to face and take responsibility for commercial decisions. However directorial morality needs recharging every so often.

Dr Finn then turns to the "same matter conflict" where one professional advisor may be asked to act for both parties on either side of the transaction. In such circumstance one is between a rock and a hard place.

Many accountants have problems in this area in regard to say valuations where one is asked to act for both parties.

My experience is that if one acts for one party and not the other, then the party for whom you do not act will be upset and accuse you of favouring the other.

If you act for both and attempt to arbitrate, and do your job properly, then probably both will be upset. Quite possibly

the best solution is to not act for either in which case both will feel snubbed and you will have no work or fee.

With regard to litigation matters the same situation can arise and where one has clients on both sides of a dispute it is probably safer not to act for either.

Dr Finn also discusses the "separate matter conflict".

Chartered accountants, and in particular auditors, find themselves in this situation quite often, where they act say for a number of clients in the same industry, such as a number of finance houses, forestry companies, etc.

This is a real problem which arises automatically where firms or individuals wish to specialise.

In such situations as this is it is quite usual for Chartered Accountants to use the "Chinese Wall" as a defence against a conflict charge.

If however one's client perceives that there has been a breach of the Chinese Wall then it is particularly difficult to convince them that there has not been such a breach.

Obviously the validity of a conflict is in the eye of the beholder and in my experience there will certainly be no predictability of which of one's clients will see conflict.

Some are more commercial minded and understanding, than others.

The Chinese Wall is defined by Dr Finn as "an organisational contrivance within an enterprise designed to prevent the flow of confidential information to or from a part of parts of that enterprise".

Sometimes it is quite difficult to conceive of this wall really working. I recall recently seeing on television, a stockbroker explaining how information was kept contained within parts of his organisation by having people in different rooms i.e. Chinese Walls. Stockbrokers are notorious for spreading rumours and information and it does somewhat stretch creditability to suggest that walls in such situations will work.

If indeed they do exist, it is perhaps because many of these walls are so thin that a number of corporate clients have turned to offshore brokers and financial advisors in recent years so as to maintain confidentiality.

Where problems over conflict of interest situations arise one will often find that the use of hindsight is most useful in clarifying ones principles. Twenty-twenty vision with a rear view mirror is not uncommon. The difficulty is that the Courts always have this benefit when hearing conflict of interest matters.

Finally Dr Finn has quite clearly expressed his doubt as to whether the Chinese Wall defence will be very effective in a large professional advisory office and I believe that those of us who convince ourselves that the device works should perhaps look again from a more objective view point. It should always be remembered that it suits us to think that the wall works. It may not suit others to see it our way.

Dr Finn

Thank you.