

POSSIBLE CONFLICT OF INTERESTS

We will discuss how Mr. Sam enters into a possible conflict of interest when appointing consultants for the company, Rock Sports Co's inventory IT System.

Facts of the case:

Rock Sports Co's CEO, Mr. Sam plans to review and revise the inventory handling system using an efficient IT system. Ms. June, the head of audit committee was informed that a firm of consultants had recently visited the company, upon the request of the CEO.

Paper & Co is currently performing the review of the company's systems and procedures. Mr. Sam, however, plans to award the contract to another organisation for handling the system after the review, to take over this process. Mr. Sam is aware that Paper & Co is proficient in this and hence would like to apply their suggestions into the system.

During the process of selection, Mr. Sam was also thinking if he can award the contract to Paper & Co, as he believes that it would be a good idea to allow the same organisation to undertake the work on which they had reported as this would possibly provide an incentive for them to work.

At that point in time, Ms. June came up with the proposal received from Brick & Co., a newly set-up company. She was the one instrumental in getting the CEO to take this project of inventory handling IT system forward based on the recent reports received from the external auditors to the audit committee. Ms. June was surprised when she heard that the CEO had readily agreed to her proposal of awarding the contract to Brick & Co for improving the inventory system without any detailed discussion. Ms. June at this point of time was unaware of Mr. Sam's relationship with Brick & Co. She was only concerned that the CEO is very mindful of spending money, for such projects.

Mr. Sam had advised Ms. June to leave the proposal for his assessment and within few days of the conversation, Ms. June heard that Brick & Co had been appointed to handle the IT system.

One day when Ms. June was visiting another factory location, she bumped into a senior storekeeper, who was not satisfied with the plan of installing the new inventory system. When enquired the reason for his frustration, he mentioned that he was surprised to hear that Brick & Co was awarded the contract instead of Paper & Co. As he is of the opinion that the contract was awarded to Brick & Co because the CFO of Brick & Co is Mr. Sam's son-in-law. He also expressed that the contract was awarded not based on the appropriateness and efficiency of the IT system for the company but was based purely on personal interests.

Ms. June was shocked when she heard about the relationship between Mr. Sam and CFO of Brick & Co.

Is there a conflict of interest which was unaddressed? What should Ms. June do now?

Analysis:

1. Ms. June must assess on the issue raised by the senior storekeeper. The storekeeper might be speculating about the relationship.
2. Does the company award contract to related parties, if so, how are they documented?
3. Mr. Sam might have compromised on the professional behaviour (*fundamental principle*), if the contract is awarded to Brick & Co.
4. Is there an apparent conflict between the parties, as Sam has awarded the contract to his own son-in-law?

Comments/Recommendations:

Ms. June noticed a conflict-of-interest created because of Mr. Sam awarding the contract to his own son-in-law for providing Inventory handling IT system, as she notices a direct connect between the parties and the matter in which parties' interests' conflict. Generally, these types of threats will not be at an acceptable level.

Ms. June should revisit and ensure the following steps were considered and applied prior to awarding the contract:

i. By awarding a contract to Sam's Son-in-law, creates threats

Mr. Sam should have considered and disclosed the nature of relationship and the consequences prior to awarding the contract to Brick & Co.

ii. The significance of the threats depends on the nature, value, intent behind and the cumulative effect of awarding the contract.

- Mr. Sam should inform the Board of Director's and Audit committee about the contract.
- Document the reason for awarding to a related party vendor and the risk associated from this contract.
- The document should also contain the possible personal interest between the parties and material influence applied in the decision-making (if any).

iii. The likely safeguards to be adopted by Mr. Sam to address this threat

- Mr. Sam should highlight and obtain consent from Brick & Co's management after explaining the consequences of accepting the contract, prior to awarding them. Failing to inform the prospective vendor would result in breach of the fundamental principles.
- Rock Sports Co should document the step-by-step process applied in selecting the vendor and seek approval from the Board members and the Audit committee.

Alternatively, if Mr. Sam had chosen Paper & Co, a self-interest and self-review threat would have arisen. As the preliminary review would have acted as an incentive for the company and since they were the ones who performed the preliminary review, they might overlook their own errors.

Ms. June should discuss the matter with the audit committee, after obtaining all the relevant information to ensure all the threats are addressed and are at acceptable level. She should verify the documentation and process in place in the event a related party is chosen as the appropriate vendor. She could also seek third parties or legal advice, if required, and take necessary steps to ensure that the threats are reduced to an acceptable level.

Hence, to ensure no conflict of interests between parties arise in future, Rock Sports Co should document the reasons (both quantitative and qualitative) for awarding the contracts. This should be discussed and approved by the Board Members and the Audit Committee.

With this we come to the end of the KLiP.