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COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

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RELEASED

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FEB 20 1973

Dear Mr. Gross:

Your letter of October 25, 1972, requested that we evaluate the United States Postal Service's October 18, 1972, letter to you which expressed the opinion that the firm of Ernst & Ernst was not involved in a conflict of interest. The Postal Service's letter responded to your letter concerning the possibility of such a conflict because of the firm's relationship with the Postal Service and with one or more mail users who participated in rate proceedings before the Postal Rate Commission.

You asked that we consider the Postal Service's comments in light of the work we performed in preparing our report to you on the Postal Service's rationale for engaging Ernst & Ernst (B-114874, Sept. 7, 1972).

We discussed this matter with officials of Ernst & Ernst and of the Postal Service and reviewed pertinent records, regulations, legislation, and the Code of Professional Ethics of the American Institute of Certified Public Accountants.

To place our comments on these matters in proper perspective, it is necessary to consider the meaning of the term "conflict of interest." The only legislation relating to this subject--in title 18 of the United States Code--is generally restricted in application to employees and officers of the Federal Government and not to contractors, such as Ernst & Ernst. To our knowledge, there is no definition of the specific circumstances, conditions, or actions that constitutes a conflict of interest in a situation such as this. Consequently, in the absence of specified criteria, the confirmation or denial of the existence of a conflict of interest on the part of Ernst & Ernst is a matter of opinion, and, in any event, without legal effect within the application of the conflict of interest laws. Within this framework, we believe that the Postal Service's assertion that Ernst & Ernst was not in conflict of interest is reasonable.

Ideally it would have been preferable for the Postal Service to have engaged a firm of certified public accountants (CPA's) whose clientele did not include any large

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mailers. It is doubtful, however, whether any of the national firms could meet this criterion because of the size and diversity of the firms' clientele. We believe that the Postal Service's interests are adequately protected, because of the nature of Ernst & Ernst's relationship to its mail user clients and because of its responsibilities under the Institute's Code of Professional Ethics.

The Institute's Code of Professional Ethics, concerning a member's relationship with clients and the public, states in rule 1.01 that a member shall not express an opinion on financial statements of any enterprise unless he, in fact, is independent with respect to such enterprise. The Institute's Committee on Professional Ethics, in its opinion on a member's independence, states that an auditor's responsibility is to avoid relationships which to a reasonable observer might suggest a conflict of interest.

In our opinion, rule 1.03 of the Institute's Code of Professional Ethics is particularly applicable to the question of the propriety of Ernst & Ernst providing accounting services to the Postal Service while providing like services to large mail users who participated in the recent postal rate hearings. This rule states that a member shall not violate the confidential relationships between himself and his client.

Thus the financial and operating information available to Ernst & Ernst during its audit of the Postal Service is of a confidential nature and not for dissemination to the firm's other clients. The Postal Service must necessarily rely on Ernst & Ernst's compliance with the Institute's Code of Professional Ethics.

During our examination of the Postal Service's rationale for engaging Ernst & Ernst, we noted that a number of the firm's clients, including a large magazine publisher, would be directly affected by postal rates. We noted also that during the postal rate hearings (1) a representative of Ernst & Ernst had testified in support of the Postal Service's method of identifying fixed and variable postal costs, (2) another

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representative of the firm had testified that the firm had been engaged by the Agricultural Publishers Association to serve as a confidential depository and to compile financial data supplied by its members, and (3) financial information compiled by the firm for the Magazine Publishers Association was placed in the hearing's record on its behalf by Foster Associates, Inc.

We believed that the above relationships indicated a potential conflict of interest. We asked a partner of Ernst & Ernst what actions the firm had taken to assure itself that no conflict of interest would arise from the firm's representing the Postal Service and other clients who could be substantially affected by postal rates. The partner said that the firm had considered this possibility and had resolved it by deciding that the firm would accept no engagements from clients that would involve representing the clients in postal rate hearings.

According to the partner, the firm had received a request from a publishers association for assistance, if needed, during the 1971 postal rate hearings but that the firm had deferred a decision on the request because the Postal Service was in the process of selecting a firm of certified public accountants. The partner said that the firm, upon being selected by the Postal Service, turned down the association's request.

According to the partner, he doubted whether any large CPA firm could accept the Postal Service as a client if having clients who were large mail users would disqualify the firm. He said that, except for the compilation of financial data mentioned above, the firm had provided no assistance to clients in rate case matters and that the firm considered this position necessary to avoid a conflict of interest.

We agree with the contention of the partner of Ernst & Ernst that a large CPA firm could not perform the Postal Service's audit requirements if having clients who were large mail

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users would be a criterion for disqualification. We agree also with the propriety of the firm's decision not to accept engagements from clients that would involve representing the clients in hearings before the Postal Rate Commission.

Because Ernst & Ernst provides auditing and accounting services to the Postal Service, the firm is in a position to acquire much information about the Postal Service's financial and operational activities. Therefore Ernst & Ernst should be particularly concerned with the Institute's rule requiring a member to observe the confidential relationship between himself and his client. We have no reason to believe that any Ernst & Ernst action has violated the firm's confidential relationship with the Postal Service.

We do not plan to distribute this letter further unless you agree or publicly announce its contents.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "James B. Peets".

Comptroller General
of the United States

The Honorable H. R. Gross
House of Representatives