

Proposed New Definition of Firm and Network Firm

Firm

- (a) A sole practitioner, partnership or corporation of professional accountants;
- (b) An entity that controls such parties through ownership, management or other means; and
- (c) An entity controlled by such parties through ownership, management or other means.

Network firm¹

(1) A firm that is part of a larger structure that is aimed at co-operation, ~~and whereby~~

- (a) the larger structure is clearly aimed at profit or cost sharing among the entities within the larger structure; or
- (b) the firm shares a common business strategy with other entities within the larger structure; or
- (c) the firm shares any of the following with an entity or entities within the larger structure:
 - ~~(i) common ownership, control or management;~~
 - (ii) common quality control policies and procedures;
 - (iii) the use of a common brand-name; or
 - ~~(iiiiv) a significant part of professional resources; or~~

(2) An entity that is under common control with the firm through ownership, management or other means.

Network Firms

290.14 To enhance their ability to provide professional services, firms frequently form associations join with other entities through thereby forming a larger structures. Such a larger structures may or may not be a legal entityies and may be created through an operating or management agreement between a firm and one or more entities. Such larger structures include those that only facilitate referral of work (where the firms may be referred to as correspondent firms) and those where the firms share a common brand name, common audit methodology and a common system of quality control.

290.14*15 An entity within the larger structure might be a firm, which is defined in the Code as a sole practitioner, partnership or corporation of professional accountants and an entity that controls or is controlled by such parties, or the entity might be another type of entity, such as a consulting practice or a

¹ This definition is to be read in the context of the guidance provided in paragraphs 290.14-26

professional law ~~firm practice.~~ The independence requirements in this section that apply to a network firm apply to any entity that meets the definition of a network firm irrespective of whether the entity itself meets the definition of a firm. Accordingly, in the paragraphs that follow the terms firm and entity are used as appropriate.

290.1~~65~~ Whether the larger structure ~~creates is~~ a network ~~that would require entities in the network to be independent of each other's financial statement audit clients is a matter to should~~ be judged based on the specific facts and circumstances, ~~irrespective of whether the entities are legally separate and distinct entities.~~ This judgment should be made in light of whether a reasonable and informed third party would be likely to conclude ~~that~~, weighing all the ~~specific facts and circumstances available, irrespective of whether the entities are legally separate and distinct entities, that~~ they are closely associated in such a way that they are part of a network. ~~This judgment should be consistently applied by firms that are part of the larger structure. If a firm determines that it is part of a network, the other entities in the network are required to be independent of the financial statement audit clients of the firm. In addition, for assurance clients that are not financial statement audit clients consideration should be given to any threats the firm has reason to believe may be created by the interests and relationships of other entities in the network.~~

290.1~~75x~~ Where the larger structure is aimed at co-operation ~~and because it~~ is clearly aimed at profit or cost sharing among the entities within the larger structure it would be considered ~~to be~~ a network. The ~~incidental~~ sharing of immaterial costs, however, would not in itself create a network ~~relationship~~. Similarly, an association ~~with between~~ a firm and another otherwise unrelated entity to jointly provide a service or develop a product would not ~~in by~~ itself create a network ~~relationship~~.

290.1~~85y~~ Where the larger structure is aimed at co-operation because and a firm entities within the larger structure shares a common business strategy, ~~with another entity within the larger structure~~ those entities would be considered ~~to be~~ network firms. Such a business strategy would be ~~related to agreed to by the entities to achieve common broad strategic issues and objectives, and~~ An entity would not be deemed to be a network firm merely because it is not intended to encompass situations where a firm forms an association ~~co-operates~~ with another entity solely to respond jointly to a request for proposal for the provision of an assurance professional services to a specific entity.

290.1~~5z~~ ~~Where the firm is part of a larger structure that is aimed at co operation and shares common ownership, control or management with an entity or entities within the larger structure, those entities would be considered to be network firms of the firm.~~

290.1916a Where the ~~firm is part of a~~ larger structure ~~is that is~~ aimed at co-operation ~~and the firm because the entities within the larger~~ structure shares common quality control policies and procedures, for example common quality control policies and procedures designed, and implemented by the entities, to comply with International Standard on Quality Control 1 “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements” issued by the International Auditing and Assurances Standards Board ~~with another entity within the larger structure~~, those entities would be considered ~~to be~~ network firms ~~of the firm~~. In this context, ~~International Standard on Quality Control 1 “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements” issued by the International Auditing and Assurances Standards Board provides that a firm’s system of quality control should include policies and procedures addressing each of the following elements:~~

- (a) ~~Leadership responsibilities for quality within the firm.~~
- (b) ~~Ethical requirements.~~
- (c) ~~Acceptance and continuance of client relationships and specific engagements.~~
- (d) ~~Human resources.~~
- (e) ~~Engagement performance.~~
- (f) ~~Monitoring.~~

290.2016 Where the ~~firm is part of a~~ larger structure ~~that is~~ aimed at co-operation ~~because entities within the larger structure and the firm uses~~ share a common brand name ~~with another entity within the larger structure~~, those entities would be considered ~~to be~~ network firms ~~of the firm~~. A common brand name includes common initials or a common name. A firm would be considered to be using a common brand name if it includes the common brand name as part of, or along with, its firm name, when, fFor example, ~~a name would be considered a common brand name if it includes a partner of the firm signs an assurance report, a significant element that is common to other firms in the larger structure (such as common initials or a common name). Such common names may be used in promotional materials or in the signing of assurance reports.~~

290.2117 If a firm sells a component of its practice, the sales agreement ~~may sometimes~~ provides that, for a limited period of time, the component may continue ~~the to~~ use the name of the firm, or an element of the name, even of the firm though ~~they it is would otherwise be no longer un~~connected to the firm. In such circumstances, while the two ~~firms~~ entities may be practicing under a common name, the facts are such that they are not part of a larger structure aimed at co-operation and are, therefore, not ~~part of a~~ network firms. ~~In such circumstances the firms~~ Those entities should, however, consider whether to disclose that they are not network firms when presenting themselves to outside parties.

290.22+8 Where the ~~firm is part of a~~ larger structure ~~that~~ is aimed at co-operation ~~and because~~ the ~~firm entities within the larger structure~~ shares a significant part of professional resources ~~with another entity within the larger structure~~, those entities would be considered ~~to be~~ network firms ~~of the firm~~. ~~Firms may share~~ Professional resources ~~such as~~ include:

- Common systems that enable firms to exchange information such as client data, billing and time recording;
- Partners and staff;
- Technical departments to ~~provide~~ consultation ~~regarding on~~ technical or industry specific issues, transactions or events for assurance engagements;
- Audit methodology, audit manuals or working papers; and
- Training courses and facilities.

290.23+9 ~~When concluding~~ The determination of whether the professional resources shared are significant and ~~t~~Therefore, ~~indicate that~~ the firms are ~~part of a~~ network firms, this consideration is to should be made based judged and weighed on the basis of all the relevant facts and dual circumstances available. Where the shared resources are limited to common audit methodology, audit manuals and working papers, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be considered to be significant. ~~There is little difference in practice between a group of firms combining to develop methodologies, and a number of firms independently purchasing proprietary audit methodology, audit manuals and working papers from a commercial developer and supplier.~~ The same applies to a common training endeavor. Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical department is created within the larger structure to provide ~~specific advice to~~ participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant ~~and that the firms are part of a network.~~

290.24 Where the firm and another entity are under common control through ownership, management or other means, for example through contractual agreements, those entities would be considered to be network firms. This will be all the more likely if the relevant firms also use their association for promotional purposes.

290.25+19a ~~A firm that does not meet the criteria of a network firm may in some circumstances wish to describe itself as being a member of an association of firms. Firms should take care to ensure that to the extent possible that such a reference does not give the appearance that they are network firms. For example this could be achieved, by stating on its stationery or promotional material that it is “an independent firm associated with XYZ Association of Accounting Firms”. If it is determined that a firm is a network firm, the other entities in the network are required to be independent of the financial statement audit clients of the firm. In addition, for assurance clients that are not financial statement audit clients,~~

consideration should be given to any threats the firm has reason to believe may be created by interests in the client held by other entities in the network or by relationships between the client and other entities in the network.

290.26 The application of the definition of a network firm should be consistently applied throughout the network. For example, if it is deemed that two entities within a large structure aimed at cooperation are network firms because they share common quality control policies and procedures designed, and implemented by the entities, another entity within that larger structure that shares the same common quality control, policies and procedures is also be deemed to be a network firm.