

Proposed New Definition of Network Firm

- Network firm
- (a) a firm that is part of a larger structure and that:
 - (i) uses a name in its firm name that is common to the larger structure; or
 - (ii) shares significant professional resources with other firms in the larger structure; or
 - (iii) shares revenues, profits, costs or expenses with other firms within the association;
 - or
 - (b) an entity that controls, is controlled by, or is under common control with the firm through ownership, management or other means.

Proposed Background Material to Definition of Network Firm

290.5 This section provides a conceptual framework for identifying, evaluating and responding to threats to independence. The framework requires members of assurance teams, firms and network firms to identify threats to independence, evaluate the significance of those threats, and, if the threats are other than clearly insignificant, identify and apply safeguards to eliminate the threats or reduce them to an acceptable level. Judgment is needed to determine which safeguards are to be applied. Some safeguards may eliminate the threat while others may reduce the threat to an acceptable level. This section requires members of assurance teams, firms and network firms to apply the framework to the particular circumstances under consideration. In addition to identifying relationships between the firm, network firms, members of the assurance team and the assurance client, consideration should be given to whether relationships between individuals outside of the assurance team and the assurance client create threats to independence.

290.5a Firms frequently form associations with other firms. Such associations range from those created only to facilitate referral of work (where the firms would commonly be referred to as correspondent firms) to those where the firms operate under a common brand name and have common audit methodology and system of quality control, both of which are mandatory.

290.5b Whether the degree of association is sufficient to create a network that would require firms in the network to be independent of each other's financial statement audit clients is something to be judged in the circumstances. This judgment is made in light of whether a reasonable and informed third party would be likely to conclude that, weighing all the factual circumstances available, the firms are closely associated in such a way that they are part of a network.

- 290.5c Where a firm practices under the same firm name (or substantially the same firm name) as other firms in the larger structure to which it belongs or includes within its name a significant element that is common to other firms in the larger structure (such as common initials or a common name), it would be considered to belong to a network unless the facts indicate otherwise. As an example of a case where the facts indicate otherwise, if a firm sells a component of its practice, the sales agreement may provide that, for a limited period of time, the component may continue the use the name, or an element of the name, of the firm though they would otherwise be unconnected. In such circumstances while the two firms may be practicing under a common name, the facts are such that they are not part of a network. In such circumstances the firms should disclose these facts when presenting themselves to outside parties.
- 290.5d The way in which a firm presents itself will be relevant. In some circumstances, a firm may not practice under the same firm name (or substantially the same firm name) as other firms in the larger structure but does describe itself as being a member of an association of firms (for example in its stationery or promotional material). A reasonable and informed third party may conclude that the such a firm is part of a larger structure and is therefore required to be independence of the financial statement audit clients of the other firms within the network. Accordingly, such firms should clearly describe the nature of the membership of the association for example by stating that it was “an independent firm associated with XYZ Association of Accounting Firms”
- 290.5e In determining whether the firms share significant professional resources, consideration is given to the nature of the relationship thereby established. Firms may share such professional resources as:
- Audit methodology, audit manuals or working papers;
 - Training courses and facilities;
 - Technical departments;
 - Data bases for matters such as time recording, billing, client information;
 - Quality control policies and procedures; and
 - Partners and staff.
- 290.5f When concluding whether the professional resources shared are significant and therefore indicate that the firms are part of a network, this consideration is judged and weighed on the basis of all the factual circumstances available. Where the shared resources are limited to common methods, 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 form a group to develop methodologies, and a number of firms independently purchasing proprietary audit methodology from a commercial developer and supplier. The same may well apply to common training endeavor. Where, however, the shared resources involve the regular 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 that the firms are required to follow, a third party is more likely to conclude that the shared resources are significant and that the firms are part of a network. This will be all the more likely if the relevant firms also use their association for promotional purposes.

- 290.5g Even though firms within a network may be legally separate and distinct entities, if they make use of a common brand name in their firm names, share significant professional resources or share revenues, profits, costs or expenses with other firms within the larger structure a reasonable and informed third party would conclude, based on weighing all the factual circumstances available, that the firms are part of a network.
- 290.6 The examples presented in this section are intended to illustrate the application of the framework and are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances that may create threats to independence. Consequently, it is not sufficient for a member of an assurance team, a firm or a network firm merely to comply with the examples presented, rather they should apply the framework to the particular circumstances they face.