

Proposed New Definition of Network Firm

Network Firms

290.14 Firms frequently form associations with other entities through larger structures. Such larger structures may or may not be legal entities and may 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.

290.14x An entity within the larger structure might be a firm, which is defined 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 professional law firm. Accordingly, in the paragraphs that follow the terms firm and entity are used as appropriate.

290.15 Whether the larger structure creates a network that would require entities in the network to be independent of each other's financial statement audit clients is a matter to be judged based on the specific facts and circumstances. This judgment should be made in light of whether a reasonable and informed third party would be likely to conclude that, weighing all the factual circumstances available, irrespective of whether the entities are legally separate and distinct entities, 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.

290.15x Where the larger structure is aimed at co-operation and 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 a firm and another otherwise unrelated entity to jointly provide a service would not in itself create a network relationship.

290.15y Where the larger structure is aimed at co-operation and a firm 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 broad strategic issues and objectives and is not intended to encompass situations where a firm forms an association with another entity solely to respond jointly to a proposal for the provision of an assurance services to a specific entity.

290.15z 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.

290.16a Where the firm is part of a larger structure that is aimed at co-operation and the firm shares common quality control policies and procedures 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 Assurance 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.

290.16 Where the firm is part of a larger structure that is aimed at co-operation and the firm uses a common brand name with another entity within the larger structure, those entities would be considered to be network firms of the firm. For example, a name would be considered a common brand name if it includes 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.

290.17 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 larger structure aimed at co-operation and are therefore not part of a network. In such circumstances the firms should consider whether to disclose that they are not network firms when presenting themselves to outside parties.

290.18 Where the firm is part of a larger structure that is aimed at co-operation and the firm 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:

- 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 technical or industry specific issues, transactions or events for assurance engagements;
- Audit methodology, audit manuals or working papers; and
- Training courses and facilities.

290.19 When concluding whether the professional resources shared are significant and therefore indicate that the firms are part of a network, this consideration is to be judged and weighed on the basis of all the factual 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 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.

290.19a 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”.

Network firm¹

A firm that is part of a larger structure that is aimed at co-operation, and

- (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;

¹ [This definition is to be read in the context of the guidance provided in paragraphs 290.14-19a](#)

- (iii) the use of a common brand-name; or
- (iv) a significant part of professional resources.

- 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.