



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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Agenda Item

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Board International Ethics Standards Board for Accountants

Meeting Location: Prague Renaissance Hotel, Prague, Czech Republic

Meeting Date: June 13- 14, 2006

Network Firm

Objectives of Agenda Item

1. To approve revised network firm definition and explanatory material
2. To determine whether the revised definition should be issued in final form or re-exposed.

Background

In June 2005, the Ethics Committee, now the International Ethics Standards Board for Accountants (IESBA), approved an exposure draft to modify the definition of a network firm. The comment period ended on September 30, 2005, of the approximately 30 comments letters received, the vast majority were supportive of the direction taken by the IESBA (with many noting that the definition should be aligned with the EU 8th directive wording).

The Task Force¹ presented draft wording to the IESBA at its February meeting. The document was also discussed with the CAG at its April meeting and input was obtained from the TAC at its April meeting.

The Task Force met in March and again by conference call in May to consider the direction of the IESBA and input received from the CAG and the TAC.

Discussion

Larger structure ¶290.14

The exposure draft refers to a larger structure. Some commented on exposure that this term was not clear and accordingly, the IESBA indicated that it would be useful to provide further clarification on this term. The Task Force proposes to indicate that the

¹ Frank Attwood (chair), Heather Briers, Ken Dakdduk, Michael Nieheus, Jean Rothbarth and Lisa Snyder.

larger structure may or may not be a legal entity and could be created through management or operating agreements between a firm and one or more entities.

Profit or cost sharing ¶290.17

At the February 2006 IESBA meeting, the term “incidental” was questioned. It was noted that costs are not generally “incidentally” shared and the issue was whether the costs were material. The TF has accordingly deleted this term.

Common quality control policies and procedures ¶290.19

At the February IESBA meeting the guidance on sharing of common quality control policies and procedures was discussed. The IESBA did not find the reference to ISQC1 as particularly helpful. The IESBA was of the view that if firms have *developed* common quality control policies and procedures they would be considered to be network firms. The IESBA felt that it would be useful if the Code contained example of common quality control policies and procedures.

The Task Force has carefully considered this issue and is of the view that without a benchmark for quality control policies and procedures it is difficult to know how much needs to be common for a network relationship to be created. If examples of common quality control policies and procedures are presented, the Task Force is concerned that it will not be clear whether one common element would create a network or whether more than one element is necessary. For example, a firm might share common working papers – even if these papers were jointly developed it would not be sufficient to develop a network relationship because, for example, other matters contained under engagement performance such as consultation, differences of opinion and engagement quality control review would not be addressed.

The Task Force is, therefore, of the view that some benchmark is necessary and accordingly, recommends that ISQC 1 be provided as an example. The Task Force is also of the view that it is useful to indicate that some firms implement common monitoring procedures to enable them to place reliance on such a monitoring system – with such a level of co-operation a reasonable and informed third party would be likely to conclude that the firms are closely associated in such a way that they are part of a network.

Disclosure of being part of an association ¶290.25

In February 2006, the IESBA agreed that the disclosure contained in paragraph 290.25 should be suggested rather than required. The IESBA did not find the sample disclosure particularly clear and asked the Task Force to give consideration to another suggested disclosure. The sample disclosure was:

“an independent firm associated with XYZ Association of Accounting Firms”.

Concern was expressed that the phrase “association of firms” was not sufficiently distinct from a “network of firms” – particularly if the phrase is to be translated. The Task Force has considered this issue and has researched current examples of disclosure that are being used. The types of disclosure are varied and include:

“In 1976, our firm joined XXX, a full-service international association of certified and chartered accounting firms. We joined XXX to support our areas of expertise and offer our clients the additional resources and knowledge base of thousands of professionals around the world.”

“Through our membership with XXX, we are networked with other large local certified public accounting firms throughout the U.S. and the world.”

“XXX is a worldwide operating network of Accounting Firms of Auditors, Tax Advisors and Accountants. We are represented in Asia Pacific, Europe, Africa and the Middle East, Latin America and North America.”

“XXX is an international association of high-quality CPA and chartered accounting firms. Our global network is organized into four active regions”

“The Firm, through its network of independent & autonomous firms, under the XXX Australasia and XXX Associates International banners, is able to access skills and research for the benefit of clients from around the World.”

“We have about xx highly qualified professional focused on understanding every client’s peculiar needs and offering high quality solutions to them. Through our membership in XX Associates International we have worldwide access to xx member firms in more than xx offices across xx countries (with more than xx professionals located in major economic areas worldwide).”

Further consideration of the issue and a review of this diverse disclosure led the Task Force to conclude that it would not be practical to develop an example disclosure which would fit all circumstances – especially given the differing legal frameworks. Accordingly, the Task Force recommends deleting the sample disclosure.

Consistent application within the network ¶290.26

At the February IESBA meeting, the Task Force proposed a change to indicate that there should be consistent application of the network firm definition through out the network. The IESBA agreed with this change but directed the Task Force to draft additional guidance to clarify that, within the network, if three entities shared the same fact pattern with a fourth entity all four would be treated the same. In addition, the IESBA felt that the Code should make it clear that if one entity treated a second entity as a network firm that second entity should also treat the first entity as a network firm.

Action requested

Board members are asked to consider the Task Force’s recommendations to changes to address comments received.

Approval

Board members are asked to approve the revised text for release. For approval the affirmative vote of at least two third of the members present at the meeting in person or by simultaneous communication link, or by proxy, but not less than twelve is required.

Action requested

Board members are asked to approve the document for release.

Re-exposure

The IESBA due process and working procedures states:

“After approving the revised content of an exposed change to the Code of Ethics for Professional Accountants, the IESBA assesses whether there has been substantial change to the exposed document that may warrant re-exposure. If so, the IESBA votes on a resolution in favor of re-exposure that is subject to the same voting rules as a vote on the issue of an exposure draft or final change to the Code of Ethics for Professional Accountants.

- *The senior technical manager of the IESBA, in consultation with the chair of the IESBA and chair of the Project Task Force, advises the IESBA on whether a draft change to the Code of Ethics, or part thereof, needs to be re-exposed.*
- *Situations that constitute potential grounds for a decision to re-expose may include, for example: substantial change to a proposal arising from matters not aired in the exposure draft such that commentators have not had an opportunity to make their views known to the IESBA before it reaches a final conclusion; substantial change arising from matters not previously deliberated by the IESBA; or substantial change to the substance of a proposed change to the Code of Ethics for Professional Accountants*

The most significant change to the document relates to alignment to the EU 8th directive. The following additional elements have been added to the definition: sharing of a common business strategy; the larger structure is aimed at co-operation and is *clearly* aimed at profit or cost sharing. The explanatory material has been re-written to be aligned with the new definition. The Task Force is of the view that the matters were aired in the exposure draft and, accordingly, commentators have had an opportunity to make views known. Accordingly, the Task Force is of the view that the revised document, nor any part thereof, does not need to be re-exposed and recommends that the IESBA issue it in final form.

Action requested

Board members are asked confirm that there is no need to re-expose the document.

Effective date

The exposure draft proposed an effective date for assurance reports dated on or after December 31, 2006. Several respondents noted that the proposed change would need to be translated and communicated to all firms within the network and that firms may need to establish cross-border mechanisms for identification and reporting of client relationships. In addition, firms are required to be independent throughout the audit period. For a December 31 year end, the firms need to be independent from January 1st.

In light of the above the Task Force recommends an effective date for assurance reports dated on or after December 31, 2008. With release of the new definition in July 2006, this will give firms and member bodies 18 months to translate and implement the changes before January 1, 2008.

Action requested

Members are asked to approve the revised effective date.

Basis for Conclusions

The IESBA due process and working procedures states that for each final change to the Code of Ethics, the IESBA issues a separate basis for conclusions document with respect to comments received on exposure. The document is issued after clearance by the Chair and the IESBA Senior Technical Manager. The issue of the document is not subject to the formal voting approval of the IESBA and therefore, does not constitute part of the final changes to the Code of Ethics and is non-authoritative.

The network firms basis for conclusion is the first such document to be issued by the IESBA. Therefore, it is presented in these agenda papers for the information of the Board. Board members will not be asked for their detailed comments on this document but may, if they wish, pass on any overall observations to staff for consideration before the document is issued for clearance.

Material Presented

Agenda Paper 2	This paper
Agenda Paper 2-A	Proposed revised wording – mark-up showing changes from Feb 2006 draft
Agenda Paper 2-B	Proposed revised wording – clean
Agenda Paper 2-C	Proposed basis for conclusions

Action requested

1. Board members are to consider the changes made by the Task Force in response to feedback received.
2. Board members are asked to approve the revised text for release.