

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, 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 quality control policies and procedures;
 - (ii) the use of a common brand-name; or
 - (iii) 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 join with other entities thereby forming a larger structure. Such a structure may or may not be a legal entity 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.

290.15 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 professional law practice. The independence requirements in this section that

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

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.

- 290.16 Whether the larger structure is a network 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, weighing all the specific facts and circumstances, that they are closely associated in such a way that they are part of a network.
- 290.17 Where the larger structure is aimed at co-operation because it is clearly aimed at profit or cost sharing among the entities within the larger structure it would be considered a network. The sharing of immaterial costs, however, would not in itself create a network. Similarly, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product would not by itself create a network.
- 290.18 Where the larger structure is aimed at co-operation because entities within the larger structure share a common business strategy, those entities would be considered network firms. Such a business strategy would be agreed to by the entities to achieve common strategic objectives. An entity would not be deemed to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for proposal for the provision of a professional service.
- 290.19 Where the larger structure is aimed at co-operation because the entities within the larger structure share 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 Assurance Standards Board, those entities would be considered network firms.
- 290.20 Where the larger structure is aimed at co-operation because entities within the larger structure share a common brand name, those entities would be considered network firms. 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, for example a partner of the firm signs an assurance report.
- 290.21 If a firm sells a component of its practice, the sales agreement sometimes provides that, for a limited period of time, the component may continue to use the name of the firm, or an element of the name, even though it is no longer connected to the firm. In such circumstances, while the two 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 network firms. Those entities should, however, consider whether to disclose that they are not network firms when presenting themselves to outside parties.

290.22 Where the larger structure is aimed at co-operation because the entities within the larger structure share a significant part of professional resources, those entities would be considered network firms. Professional resources include:

- Common systems that enable firms to exchange information such as client data, billing and time records;
- Partners and staff;
- Technical departments to consult 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 The determination of whether the professional resources shared are significant and therefore, the firms are network firms, should be made based on the relevant facts and circumstances. 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. 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 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.

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.

290.25 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.