

Consideration of Networks¹—Issues and Discussion

Objective of the IAASB Discussion

The objective of this Agenda Item is to obtain the IAASB's feedback on the matters set out below from the Quality Control Task Force (QCTF), the ISA 220² Task Force and the Group Audits Task Force (GATF) (hereafter the 'Task Forces')³ on 'network' related matters.

A. Introduction

1. Paragraph 54 of ISQC 1 refers to the fact that some firms operate as part of a 'network of firms.' Firms are organized under many different arrangements that may or may not meet the current definition of a network in the International Ethics Standards Board for Accountants' (IESBA) *Code of Ethics for Professional Accountants* (the IESBA Code)⁴ and the IAASB's International Standards (i.e., ISQC 1 and the ISAs). Currently, the IAASB's International Standards do not establish requirements for firms at the network level nor do they address in any significant detail a firm's ability to place reliance on network policies or procedures to address firm-level or engagement-level responsibilities for quality management.
2. Regulators and audit oversight bodies have expressed concerns related to networks, with issues being highlighted in their inspection findings. In particular, regulators and audit oversight bodies have noted that:
 - Firms, in some circumstances, may seek to rely on a network's system of quality control to address some of the firm's responsibilities established by ISQC 1, without sufficient basis for doing so.
 - ISQC 1 only makes brief reference to monitoring procedures that may, or may not be, performed at the network level.⁵

¹ For the purposes of this Agenda Item, the term 'network' is used to describe larger structures that meet the network definition in ISQC 1, and the term 'network activities' is used in the context of policies, procedures and other activities in place or performed at the network-level that may be relevant to the firm's quality management (see paragraph 12).

² International Standards on Auditing (ISA) 220, *Quality Control for an Audit of Financial Statements*

³ The issues and possible actions relating to networks set out in this Agenda Item have been discussed by the Task Forces, including a joint discussion by the QCTF and ISA 220 Task Force in April 2017. The Task Forces continue to work together on these matters as they relate to possible actions that are interrelated between the projects to revise International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements and Related Services Engagements*, ISA 220 and ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

⁴ For the purpose of this Agenda Item, references are made to the provisions in the extant IESBA Code. As part of the Structure of the Code Project, restructuring revisions have been made to those extant provisions, including to those that are relevant to "networks" or "network firms." The restructuring revisions are not however intended to change the meaning of the provisions in the extant Code.

⁵ See paragraph 54 of ISQC 1

- Networks that carry out inspections of individual firms, as part of their monitoring procedures, do not always adequately consider the implications of those findings, including the impact of those findings on other firms within the network.
 - Their ability to access audit documentation of other firms in the network, including the ability of the firms within the network to share information with regulators and audit oversight bodies, is limited or difficult in some cases.⁶
3. In addition, questions have arisen about whether, how, under what circumstances, and to what extent engagement teams can rely on common systems of quality control when using work performed by other auditors from the same firm or a network firm (e.g., in group audit situations).
 4. For example, the group engagement team's involvement in the work performed by the component auditor that is not part of the network may need to be different, and the nature and timing of such involvement may also need to be different, when they are not subject to, for example, the same quality control policies and procedures or methodologies. For example, depending on the circumstances, more detailed instructions, and more frequent and more in-person communications between the group engagement team and component auditors may be necessary as the audit progresses.
 5. As noted above, issues related to networks could affect management of quality by the firm (i.e., ISQC 1) and at the engagement level (i.e., ISA 220 and ISA 600). The IAASB therefore included the issues relating to networks in the ITC, setting out the identified issues at both the firm and engagement level. In presenting these issues, the IAASB recognized that networks have significantly different structures and it would therefore likely be challenging to develop standards that would be effective in addressing this broad range of arrangements. Further, it was acknowledged that networks' structures, and the way that firms within the networks interact, continue to evolve and any standard-setting actions to address issues related to networks needed to remain principle-based and able to be applied to evolving circumstances. The ITC sections addressing networks, including the possible actions to address the identified issues relating to networks are set out in Appendix A.
 6. The responses to the ITC confirmed the issues and concerns, and encouraged the IAASB to further explore these matters by considering changes to the IAASB's International Standards as appropriate. Respondents highlighted the importance of the relationship between networks and their member firms, and the potential implications of such relationships on audit quality. Respondents also emphasized the need for, and the importance of, actions for ISQC 1 to be strengthened in relation to consideration of inspections that have taken place across networks, and related communications. A summary of the responses to the ITC can be found in the Supplement to Agenda Item 2.
 7. The IAASB approved a [project proposal](#) to commence projects to revise ISQC 1, ISA 220 and ISA 600 at its December 2016 meeting.

⁶ This issue was included in the Invitation to Comment (ITC), [Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits](#) as feedback from regulators and audit oversight bodies, however standard-setting will not be able to address this matter as it relates to restrictions imposed by jurisdictional laws and regulations. Therefore, it will not be explicitly addressed as part of the projects to revise ISQC1, ISA 220 and ISA 600. However, when dealing with risks relating to a firm's compliance with relevant laws and regulations in ISQC 1, it may be appropriate to include as an example, law or regulation within a jurisdiction that requires firms affirm that regulators will be able to gain access to working papers and personnel as a condition of licensing or registration.

8. With the exception of providing high-level feedback from the ITC responses at the September 2016 IAASB meeting, the IAASB has not had further discussions about the topic of networks since the ITC was issued. The last discussion by the IAASB's Consultative Advisory Group (CAG) on this topic was during the development of the ITC (see relevant minutes in Appendix B). Representatives of the IAASB discussed network related matters, including the broad approach described in this Agenda Item, with members of the Forum of Firms (FoF) at their May 2017 meeting. The FoF's members were broadly supportive of the direction, and encouraged the IAASB to continue to consider how networks are structured when making changes (i.e., to not develop requirements which would be difficult to implement because of the different structures of networks). They also further iterated the need for clarification on what the 'basis of reliance' should be when 'relying on' common policies and procedures.

What Is a Network?

9. The IAASB and the IESBA have a common definition of a network in their standards. The definition can be found in Appendix C, which also includes a summary of how networks are described or defined in certain other standards, laws or regulations.
10. The definition of a network in the IAASB's International Standards and the IESBA Code is very broad, and contemplates the wide variety of networks that may exist, comprising of larger structures that may share some, or all of, the following elements among the entities within the structure (see Appendix D for the discussion of Networks and Network Firms in the IESBA Code):
- Use of a common brand name;
 - Common quality control policies and procedures;
 - Aimed at profit or cost sharing among the entities within the structure;
 - Common ownership, control or management;
 - Common business strategy; or
 - A significant part of professional resources (see below).
11. The IAASB's International Standards do not elaborate on 'professional resources' but the IESBA Code sets out the examples in paragraph 290.23 of the IESBA Code, including:
- Common systems that enable firms to exchange information such as client data, billing and time records;
 - Partners and staff;
 - Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements;
 - Audit methodology or audit manuals; and
 - Training courses and facilities.
12. The definition of a network is well-established and accepted in both the IAASB's and IESBA's standards. It is the Task Forces' view that the approach described as follows for addressing the issues relating to networks can be applied in the context of the extant definition. The approach described is based on circumstances when the network has common policies and procedures, and not simply on whether or not there is a larger structure to which the firm belongs that meets the

current definition of network. The Task Forces also note that making any changes to the definition of a network would need to be coordinated with IESBA, i.e., in order to maintain consistency with how networks are defined in both the IAASB's International Standards and the IESBA Code. In the view of the Task Forces the issues around networks do not arise because of the definition of a network, and therefore the Task Forces are of the view that the definition does not need to be amended.

B. Activities Performed at the Network Level: Firm Responsibilities

13. Certain activities within a firm's system of quality management could be performed wholly or in part at a network level. Additionally, there may be common policies and procedures that are expected or required to be used by all firms within the network (network firms). For example:

- The network may develop the audit methodology and related audit software and require that they be used by all network firms.
- The network may establish policies and procedures related to independence that are expected to be implemented by each network firm. In addition, the network may implement systems at a network level to facilitate or contribute to the effective functioning of such policies and procedures at the firm level.
- The network may perform the monitoring of network firms' systems of quality management, including through the performance of periodic practice reviews and monitoring the results of external inspections of network firms.
- The network may establish technical resources to support the consultation process and to addressing differences of opinion that may arise between network firms.

In the rest of this paper, such matters as noted above are referred to collectively as "activities performed by the network."

Developing Network-Level Requirements

14. As previously noted, network arrangements and the activities performed by a network may vary significantly. Firms within a network are generally not owned or directly controlled by the network. The extent of operational and decision-making power at the network level can also vary among networks and enforcement powers in relation to individual network firms may be limited. Compliance at the network firm level with common quality control policies and procedures, and common methodologies, can be influenced through economic and other measures, but often cannot be centrally controlled at the network level.

15. The ITC acknowledged the challenges of trying to establish requirements in ISQC 1 at the network level, including that:

- Networks may be structured differently.
- The nature and extent of the common policies and procedures in networks will vary, likely significantly.
- Structures may be highly influenced by applicable law or regulation in the various jurisdictions in which networks and individual firms are established.

Nevertheless, the ITC asked for stakeholder views about whether requirements at the network level should be further considered by the IAASB.

16. Respondents to the ITC recognized the challenges associated with developing requirements at the network level in the IAASB's International Standards, and were generally therefore supportive of the IAASB taking action to address the issues at the firm level or engagement level (although a few were supportive of the establishment of requirements at the network level).⁷ Those respondents who recognized the challenges of establishing requirements at the network level highlighted the varying network structures that exist and the inability of the IAASB to develop requirements that would be adaptable to the wide variety of circumstances that can and do arise in practice. However, there was strong support, across all stakeholder groups, for the IAASB to give further consideration to enhancements to the standards to clarify what a network firm's "basis of reliance" should be when relying on common policies and procedures at a network level (i.e., what needs to be done by network firms to demonstrate that what they are relying on has an appropriate basis and is operating as expected).
17. The Task Forces further considered the merits and consequences of establishing requirements at the network level in the IAASB's International Standards, and agreed that this would be challenging for various reasons and therefore unlikely to result in effectively addressing the issues identified. In particular, the Task Forces considered:
- The different structures of networks (for example, varying common elements across networks, variances in the activities performed by networks, structures that are called networks that may not have common quality control policies and procedures, or significant differences in the nature and extent of the common policies and procedures and how these are implemented).
 - The different degrees of centralized control that exist across networks (including potentially very little in a larger structure referring to itself as a network without having common policies and procedures).
 - Difficulties that would arise with monitoring compliance with network-level requirements (especially by external oversight bodies), because of the multi-jurisdictional nature of networks and the firms within those networks being subject to different laws and regulations, including oversight by audit regulators.

Activities Performed by the Network Being Used by a Network Firm as Part of Its System of Quality Management

18. The Task Forces agreed with the ITC respondents that further consideration should be given to what a network firm should do in relation to information coming from the operation of network activities.
19. As described in the ITC, regulators and audit oversight bodies have raised concerns that in certain cases firms rely on network-level activities to address firm-level requirements, but without sufficient information about how those activities operate at a network level and about how effective they are. Consequently, firms may not be able to demonstrate their basis for relying on those activities (i.e., have been able to demonstrate that those activities are sufficiently effective for the intended purpose).
20. Complying with the requirements of ISQC 1 is the firm's responsibility. In circumstances when network activities are used by a network firm as part of addressing its risks to quality within the firm's

⁷ Basel Committee on Banking Supervision, CFA Institute, The Investment Association, International Corporate Governance Network, Crowe Horwath International.

system of quality management, the Task Forces are of the view that the firm has a responsibility to proactively:

- Understand the network activities;
- Make a determination as to whether the network activities are relevant to, and support, the firm's system of quality management (i.e., whether they are relevant and effectively designed to address firm-level quality risks); and
- Consider information about the effectiveness of those activities (i.e., to support a conclusion that they are appropriate and effective in addressing firm-level quality risks).

21. Accordingly, the Task Forces recommend that ISQC 1 should be strengthened to address the responsibilities referred to in paragraph 20. These revisions to ISQC 1 would support a more proactive approach to considering and using information from network activities at the firm-level, and is consistent with the principles proposed by the QCTF in relation to the incorporation of a quality management approach in ISQC 1. The Task Forces are also of the view that this approach would:

- Be adaptable to the different components of a firm's system of quality management (see paragraph 21 of **Agenda Item 2-B**).
- Encourage more robust two-way communication between the firm and the network, which aligns to the proposals in the component "information, communication and documentation" in **Agenda Item 2-B**.
- Be adaptable to the various types of networks as it would be up to a firm to determine whether and how the activities performed by the network would support the firm's system of quality management and address risks to quality at the firm level, i.e., the approach could be applied regardless of how a network is structured, or the extent to which the network adopts common policies and procedures.

22. In understanding the activities performed (as set out in paragraph 20 above) at a network level and in considering related information provided by the network, it would be the network firm's responsibility to evaluate whether those activities are appropriate and effective, and whether the network firm has sufficient information from the network to form the basis for the firm's conclusion. For example, in determining whether the audit methodology established by the network is appropriate and effective, the network firm will consider information provided by the network about matters such as:

- The process of developing the audit methodology such that it complies with the ISAs and any network-level requirements, as well as details about the quality review processes that are undertaken in their development.
- How the audit methodology is updated for changes in standards or network-level expectations, and how it is determined that any changes to the methodology are timely, complete and appropriate, including details about the quality review processes that are undertaken.

The network firm may seek additional information from the network to assist in making a determination about the appropriateness and effectiveness of the audit methodology. Accordingly, the responsibility would be on the network firm for seeking additional information from the network as necessary. If the network is unable to provide the requested information about network activities, the network firm would then need to implement other actions to satisfy

itself about the appropriateness and effectiveness of the audit methodology. In this example, if the network could not provide the necessary information about how the audit methodology is developed and maintained, the firm would need to perform additional procedures at the firm level.

23. In designing its system of quality management, the network firm would consider the information about the network activities obtained from the network, including performing an evaluation of the appropriateness and effectiveness of these activities in addressing quality risks at the firm level. Accordingly, the necessary actions or responses at the firm level may differ depending on the network activities involved and the network firm's evaluation thereof. Furthermore, the firm would consider jurisdictional aspects (e.g., legal or regulatory requirements or local professional standards). For example, in relation to the audit methodology example above, the firm may determine that there is little, if any, further action required by the firm in order to use the network's methodology; however the firm may identify the need to perform additional firm-level activities to supplement the network methodology to appropriately address local jurisdictional requirements.
24. The firm may determine that a more detailed understanding is needed in relation to certain activities performed at a network level and therefore seek more information from the network in order to make appropriate conclusions at the firm level. For example:
 - In the case of audit software, firms may seek an understanding of how the use of the tools has been vetted, including how the determination has been made that the tools are 'fit for purpose' and will function as intended. Network firm may also seek to understand what the expectations are about those processes and controls the firm needs to put in place around the deployment of such tools. Those expectations may include, for example, expectations relating to:
 - Proper deployment of, and controls over, the use of the software;
 - Having appropriate IT infrastructure in place to support the software;
 - Delivering the necessary training for engagement teams;
 - Communicating to engagement teams what they are expected to do in order to use the tools effectively; or
 - Providing technical support.
 - In the case of network-level monitoring activities, network firms may seek to understand the nature, timing and extent of firm-level monitoring activities in relation to the various aspects of network firms' system of quality management, including how the results are communicated and whether they take account of all relevant information (including from external sources) on a timely basis. Firms might seek additional information about deficiencies identified, the causes of the deficiencies and what is being done to remediate them. These activities are likely particularly relevant to firms that make extensive use of other firms within the network when performing group audits.
25. In the view of the Task Forces, the inclusion of robust requirements directed at the firm to more proactively understand network-level activities and to consider or evaluate the information in the

context of information about such activities being used by the firm to comply with ISQC 1's firm-level requirements would:

- (a) Strengthen what the network firm has to do in relation to network-level activities, including the related policies and procedures, and would cause the network firm to more actively consider and seek out relevant information from the network about such activities i.e., in order to provide the basis for how the firm's responses to quality risks are addressed by such activities and the related policies and procedures.
- (b) Influence what the network does and what kind of information is provided to network firms within the network. For example, all the firms in the network would likely be requesting similar information from the network, which would in turn may drive the networks to more consistently provide the network firms with the necessary information on a transparent and timely basis. The Task Forces are therefore of the view that setting robust, clear requirements at the firm level for how the network-level activities and related policies and procedures should be considered by firms (i.e., as responses to quality risks within the overall system of firm-level quality management) will improve quality overall, which is clearly in the public interest.

C. Activities Performed at the Network Level: Engagement Team Responsibilities

26. At the engagement level, when managing quality, the engagement partner and the engagement team have the responsibility to understand the activities performed at the firm level that are relevant to managing quality at the engagement level. Extant ISA 220, paragraph 4 indicates that "Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise." This paragraph is supported by application material (paragraph A2) that indicates that the engagement team may rely on the firm's system of quality control in relation to, for example:

- Competence of personnel through their recruitment and formal training.
- Independence through the accumulation and communication of relevant independence information.
- Maintenance of client relationships through acceptance and continuance systems.
- Adherence to applicable legal and regulatory requirements through the monitoring process.

As the Task Force continues to progress changes to ISA 220, and in light of the IAASB's views of the matters set out in this paper, the Task Force will make necessary revisions to these paragraphs in ISA 220.

27. Information from network firms is only addressed in extant ISA 220 in the context of:

- Complying with relevant independence requirements - paragraph 11 (a) of ISA 220 requires that the engagement partner obtain relevant information from the firm, and where applicable, the network firms, to identify and evaluate circumstances and relationships that create threats to independence.
- Considering the results of the firm's monitoring process – paragraph 23 of ISA 220 indicates that this would be as evidenced in the latest information circulated by the firm and, if applicable other network firms.

28. The proposed revisions to ISA 220 (see **Agenda Items 5-A** and **5-B**) involve more proactive consideration by engagement partners and engagement teams of the relevant firm-level activities, and information about their effectiveness relative to managing quality at the engagement-level – an approach that is very similar to that outlined in the section above as to how firms might consider network-level policies and procedures. The Task Forces also understand and agree that it would, for the most part, likely not be practical, nor efficient, for individual engagement partners and engagement teams to be required to seek information directly from the network about network activities and their effectiveness. The Task Forces therefore believe that, in general, consideration of network-level activities would likely be more relevant and appropriate to be conducted by the firm, with the firm then having the responsibility for distributing appropriate information to engagement partners and engagement teams. In the view of the Task Forces, the information distributed by the firm forms the basis for the engagement’s partner’s conclusions as to how quality is managed at the engagement level.
29. For example, networks may establish policies and procedures related to independence that are expected to be implemented by each network firm, and systems are implemented at a network level to facilitate or contribute towards the effective functioning of such policies and procedures. The network firm would likely implement the necessary firm-level policies and procedures and may have already obtained information about, and evaluated the effectiveness of, the operation of the information obtained from the network-level systems. In such cases it would likely be appropriate that this process is used as the basis for how risks related to compliance with relevant independence requirements are managed at the engagement level, and how this is monitored and remediated. However, in doing so, and consistent with other changes being considered in ISA 220, the engagement partner and engagement team would also consider whether there are other risks to quality relating to independence and whether any additional procedures are necessary at the engagement-level. For example, the engagement partner might determine that the network-level activity is not a sufficient response to the risk to quality at the engagement level, and might therefore decide to obtain positive confirmations from all team members directly (e.g., confirmations that they have read and understood the applicable independence requirements and that they are in compliance, or if not, that instances of possible or actual non-compliance have been brought to the attention of the engagement partner).
30. In some cases, it may be necessary for individual engagement partners or teams to base conclusions on how quality is managed at the engagement level that involve taking into account network-level activities that have not been otherwise evaluated or considered at the firm level, or where additional information is needed from the network about the effectiveness of the applicable network-level activities. In these cases, the engagement partner may ask the firm to request the necessary information from the network on behalf of the requesting partner or team. However, if the firm does not do so, then the engagement partner may find it necessary to reach out to the network to obtain the necessary information directly. If the necessary information is not provided, the engagement partner would need to consider the implications for managing quality at the engagement level, and determine what additional actions are necessary in the circumstances.

D. Activities Performed by the Network: Group Audit Situations

31. ISA 600 deals with the special considerations that apply to group audits, in particular those that involve component auditors. ISA 220 applies to all audit engagements, and therefore in a group audit situation the requirements of ISA 220 will need to be considered for the engagement as explained

above. It is assumed that the proposed strengthened communication requirements would facilitate the improved flow of information down to the group engagement teams and component auditors involved in the group audit. Further, as the group engagement team and the group engagement partner obtain the required understanding of the component auditor (e.g., understand their competence and capabilities), they also need to understand the activities performed at network level that are related to the component auditor and relevant to the group engagement. If the network firm of which the group engagement team is a part has not obtained the necessary information from the network about the activities that are performed at network level, and which are likely relevant to the component auditor, the group engagement team would need to proactively seek that information (either through the group engagement team's firm, or directly from the network).

32. The Task Forces have also discussed the possible approaches for obtaining information from a network that may be relevant to the various engagements that the firm performs. For example, as part of its quality management system, the firm could identify what information is needed from the network because of its relevance to multiple engagements performed by the firm involving auditors from other network firms, and establish procedures for gathering such information from the network, evaluating the effectiveness of network level activities and communicating the necessary information to the engagements that need it. In this way, individual engagement teams would not have to directly make inquiries or seek information from the network. When a firm has several group engagement teams using the work of the same component auditor from another network firm, relevant information about that component auditor could be obtained by the firm and communicated to those engagement teams, instead of each individual group engagement team having to make the same inquiries. The Task Forces also noted that in many cases information provided by the network firm or the network would have to be supplemented by additional inquiries, observations and other procedures at the engagement level. It is the Task Forces' view that developing robust application material to explain this process would be helpful in encouraging firms to obtain information in the most effective and efficient way. However, the revisions to the IAASB's International Standards should not be too prescriptive with respect to the nature and extent of information that has to be obtained from the networks, or the manner in which it should be obtained.

E. Further Considerations by the Task Forces for Improving the IAASB's standards

33. The Task Forces are of the view that the proposed strengthening of the requirements in ISQC 1 and in ISA 220 related to communication (see **Agenda Item 2-A** and **Agenda Item 5-A**) should also address communications between networks and firms, and where applicable or necessary, between engagement partners or engagement teams and networks. The Task Forces also have the view that application material describing various activities which are typically performed by networks could be developed, including illustrations of what the firm or an engagement team might be expected to do to demonstrate that they are more proactively considering the network activities and the information provided by networks about their effectiveness.
34. Further consideration will need to be given regarding documentation requirements, including the expected level of documentation relating to how a network firm or an engagement team can demonstrate the basis for decisions made about the appropriateness of incorporating network activities into responses for managing quality at either the network firm or the engagement level.
35. In developing the changes to ISQC 1, ISA 220 and ISA 600, the interaction between the standards has been highlighted. ISQC 1 forms the foundation for quality management, with further consideration

about how to embed the concept of managing quality at the engagement level by the engagement partner in ISA 220. In ISA 600, aspects of an audit that are particular to a group audit situation are further considered, in addition to the requirements of ISQC 1 and all the ISAs, including ISA 220. Accordingly, the overarching requirements regarding using network level activities would be established in ISQC 1, with further consideration at the engagement level in ISA 220. ISA 600 would then 'build' on those standards for the aspects that would be particular to group audit situations, likely through application material that would provide further guidance for those specific aspects (e.g., evaluating the competence of component auditors). In addition, the application material could help distinguish the considerations of the group engagement team when using the work of a component auditor that is part of the network and when it operates outside of a network.

Matters for IAASB Consideration:

1. Does the IAASB agree with the overall direction being contemplated by the Task Forces i.e., to strengthen and enhance the requirements and application material in ISQC 1, ISA 220 and ISA 600, and require more proactive consideration or evaluation by network firms, and at the engagement level, before “relying” on network-level quality management activities (for example, a common methodology and tools, monitoring conducted at a network level and related communications)?
 - (a) What is the IAASB’s view about the work effort that would be necessary to demonstrate the basis for appropriate reliance at the firm and the engagement level? Would the necessary work effort vary depending on what is being relied upon? What are the documentation considerations?
 - (b) What are the practical implications of strengthening the requirements as proposed? What challenges would be likely to arise?
 - (c) Are there other aspects relating to networks that need to be addressed and/or strengthened in the IAASB’s International Standards?
2. Does the IAASB agree with the Task Forces’ view that, at this time, no further consideration be given to the definition of “network”?

ITC Sections Addressing Networks

The Firm's Role in Supporting Audit Quality

105. In the current evolving environment, firms are operating in many and varied ways that potentially affect the way that firms and engagement teams are structured and how audits are performed. We believe it is necessary to give further consideration to issues arising in relation to these matters, including:
- (a) Firms that operate through arrangements that share:
 - (i) Common policies and procedures for performing the work (e.g., audit methodologies);
 - (ii) Common quality control policies and procedures; or
 - (iii) Common monitoring policies and procedures.⁸
 - (b) Models with service delivery that are different to traditional engagement team structures. These are sometimes referred to as “audit firm shared service centers,” “centers of excellence,” “on-shoring,” “offshoring,” or “outsourcing” (referred to in this ITC as ADMs).

Quality Control Considerations When Operating as Part of a Network

106. ISQC 1 refers to the fact that some firms operate as part of a network of firms. The definition of a network in ISQC 1 contains elements that are broader than the sharing of common quality control policies and procedures and common methodologies. In reality, networks of firms vary significantly and the extent of sharing of and reliance on common quality control policies and procedures and common methodologies can vary considerably. For purposes of this ITC, the term “network of firms” (network) refers only to arrangements where firms share common quality control policies and procedures or common methodologies. The following are often observed in network arrangements:
- Firms within a network are not owned or controlled by the network entity for various reasons, including jurisdictional law and regulation, and risk and litigation management purposes.
 - The extent of operational and decision-making power at the network level varies among networks and enforcement powers in relation to individual network member firms may be limited. Compliance at the individual member firm-level with shared common quality control and monitoring policies and procedures and common methodologies can be influenced through economic and other measures, but often cannot be centrally controlled.
107. Currently very few jurisdictions have law or regulation that govern networks and the way they are structured and managed. Where such law or regulation exists, application is generally limited to firms that operate within the jurisdiction. We acknowledge that firms may be organized under many different arrangements, and recognize that our standards cannot mandate or anticipate all the ways in which firms might be structured today or in the future.

⁸ Firms that operate through such arrangements are typically referred to as a network or network firms. Our standards define a “network” as “A larger structure that is (a) aimed at cooperation; and (b) is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources”.

108. ISQC 1 and the ISAs do not establish any requirements for firms at the network level nor do they address in any significant detail a firm's ability to place reliance on network policies and procedures to address firm-level or engagement-level responsibilities for quality control.
109. A firm that operates as part of a network may seek to rely on the network's system of quality control (including monitoring policies and procedures), to address some of the firm's responsibilities established by ISQC 1. In relation to this, concerns have been raised by regulators and audit oversight bodies that there may be undue reliance by firms on the network's system of quality control in some circumstances.
110. More specifically, regulators and audit oversight bodies have:
- Highlighted that ISQC 1 does not extend to, or address, the monitoring procedures that may, or may not be, performed at the network level.
 - Expressed concerns that networks are not adequately considering the results of external inspection findings of individual firms within the network, and their implications to the network as a whole, and making appropriate communications about such matters within the network.
 - Noted concerns about their ability to access audit documentation of other firms in the network, including the ability of firms within the network to share information with them.
111. At the engagement level, issues have arisen about whether, how and under what circumstances engagement teams can rely on the common systems of quality control when using work performed by other auditors from the same firm or a network firm. Specifically, concern has been raised about a group engagement team placing reliance on the firm or network quality control policies and procedures without due consideration of an appropriate basis for doing so. For example, we have heard concerns about situations when a group engagement team may place reliance without conducting a proper assessment on network-level policies and procedures relating to independence, and competence and capabilities of the component auditor (i.e., because the component auditor is believed to have or be subject to the same quality control policies and procedures as the group engagement team).

References to Existing Requirements and Application Material

112. Where firms are within a network that operates under common monitoring policies and procedures, and the firms have implemented monitoring procedures on a network basis that are relied on by the individual firms, ISQC 1 requires firm policies and procedures for communication by the network:
- At least annually, of the overall scope, extent and results of monitoring process to the firms within the network; and
 - Of any deficiencies in the system of quality control to the firms in the network so the necessary action can be taken.⁹
113. ISA 600 sets out application material relating to considerations about how the group engagement team's procedures may be affected by whether the group engagement team and component auditor have common policies and procedures for performing the work, common quality control policies and

⁹ ISQC 1, paragraph 54

procedures or common monitoring policies and procedures.¹⁰ ISA 220 provides for the ability of the engagement team to rely on the firm's system of quality control, unless information provided by the firm or other parties suggest otherwise.¹¹ This may include, for example, competence of personnel, independence, maintenance of acceptance and continuance systems, and adherence to applicable legal and regulatory requirements through the monitoring process.¹²

Possible Actions to Address the Issues

114. Clarity in ISQC 1 and ISA 220 about what should be considered and documented by the individual firm as a basis for the reliance on network policies and procedures at the firm level (including for example, a common audit methodology or audit technology) is important. While recognizing the importance of maintaining principles-based standards, specific actions we could take include:
- (a) Revisiting the existing requirements and application material in ISQC 1 to more explicitly address the considerations about the extent to which firms can rely on network quality control and monitoring policies and procedures in designing policies and procedures to comply with ISQC 1 at the firm level. This could include, for example, more clearly describing what the firm is required to do at the firm level, and the engagement level, to appropriately rely on network firm quality control and monitoring policies and procedures. Such revised requirements would need to address what would be expected if the component auditor did not share common quality control and monitoring policies and procedures. We may need to explore alternatives that have similarities to the “service organization” concept followed by corporate entities that choose to rely on others for certain aspects of their financial reporting obligations and the related reporting by service auditors (i.e., using the principles of ISA 402¹³ and ISAE 3402).¹⁴
 - (b) Strengthening the requirements and application material in ISQC 1 in relation to inspections that have taken place across the network and related communications, including, for example, providing more specificity about:
 - (i) The impact on the firm, and for an engagement, if applicable, of the outcome of these inspections, addressing circumstances where law or regulation may preclude the sharing of information.
 - (ii) How the firm responds to the inspection findings.
 - (iii) The impact on the firm's own system of quality control, including monitoring policies and procedures, designed to comply with ISQC 1.
115. Paragraph 242(c) sets out possible actions to address issues in a group audit relating to reliance at the engagement level on common systems of quality control and monitoring when using work performed by component auditors from the same firm or a network firm.
116. In exploring possible changes to the standards in relation to network firms, we have recognized that network and firm structures may be highly influenced by law or regulation in the various jurisdictions

¹⁰ ISA 600, paragraphs A33–A34

¹¹ ISA 220, paragraph 4

¹² ISA 220, paragraph A2

¹³ ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

¹⁴ International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Service Organization*

where networks and individual firms are established. Mixed views have been expressed about whether requirements for networks themselves could or should be established. We believe it would likely be very challenging for us to develop requirements for networks because:

- Networks or alliances may be structured differently.
- The nature and extent of their common policies and procedures will vary.
- Structures may be highly influenced by applicable law or regulation in the various jurisdictions in which networks and individual firms are established.

We would therefore like to understand stakeholder views on this matter to be able to determine a way forward.

Issues Relating to the Group Engagement Team's Involvement in the Work of the Component Auditors¹⁵

235. In finalizing ISA 600 as part of our clarity project, we agreed that the requirement for the group engagement team to be involved in the work of the component auditor should be retained, but allowed flexibility for the group engagement team to determine the appropriate nature, timing and extent of such involvement based on the circumstances. In addition, we considered whether to mandate a minimum quantitative threshold for the involvement of the group engagement team in the group audit, but agreed that this would conflict with the risk-based nature of the standard.
236. As discussed in paragraph 70, the group engagement partner takes responsibility for direction, supervision and performance of the group audit engagement.¹⁶ When component auditors perform work on the financial information of components, and the group engagement team will use this work when obtaining evidence on which to base the group audit opinion, the ISA requires that the group engagement team be involved in the audit work of the component auditors to the extent necessary to obtain sufficient appropriate audit evidence.
237. The group engagement team's involvement in the work of the component auditors depends on a number of interrelated factors and judgments, such as the competence and capability of the component auditor, the expected communications between the group engagement team and the component auditors, the identification of significant components and the determination of the necessary work relating to non-significant components. The appropriate nature, timing and extent of the involvement of component auditors will therefore vary according to the circumstances of each group audit engagement (e.g., considering the significance of the components, the significance of the risks of material misstatement related to the components and the results of the understanding of the component auditors), but it must be to the extent necessary to obtain sufficient appropriate audit evidence in order to form the basis for the opinion on the group financial statements.

Issues

238. Some regulators and audit oversight authorities have raised concerns that involvement of the group engagement team in the work of the component auditors is not always adequate, particularly in instances where the group engagement partner is not located where the majority of the audit work is

¹⁵ This section is included because of the relevance of network issues to situations involving component auditors from the same network of firms.

¹⁶ Paragraph 11 of ISA 600

performed. For example, it has been noted in some audit inspection reports that the nature and extent to which the group engagement team specifies or communicates risks of material misstatement, or expected responses, to component auditors varies, resulting in different levels of understanding and potentially different responses. Additionally, ISA 600 does not include guidance about how to deal with situations in which the group engagement team is also performing work at the component level.

239. In addition, certain audit inspection reports have noted that the judgments around the nature, timing and extent of the group engagement team's involvement in the work performed by component auditors, and the reasons therefore, are not always clearly demonstrated (including the documentation by the group engagement team of the relevant considerations supporting its conclusions).

References to Existing Requirements and Application Material

240. The group engagement partner is responsible for the group audit engagement. Where component auditors will perform work on the financial information of components, as part of the acceptance and continuance of the engagement, the group engagement partner is required to evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to determine whether the evidence obtained is sufficient and appropriate in the circumstances and that it will support the conclusions reached.¹⁷
241. ISA 600 requires the group engagement team to determine the type of work to be performed on the financial information of the components (by the group engagement team or by component auditors on its behalf), and to determine the nature, timing and extent of its involvement in the work of the component auditors.¹⁸ For significant components, there is a requirement for the group engagement team to be involved in the component auditor's risk assessment process to identify significant risks of material misstatement of the group financial statements.¹⁹ ISA 600 specifically requires documentation of the type of work to be performed on the financial information of components,²⁰ and the nature, timing and extent of the group engagement team's involvement in the work of the component auditors on significant components including, where applicable, the group engagement team's review of relevant parts of the component auditor's audit documentation and conclusions thereon.²¹ Guidance about factors²² that may affect the group engagement team's involvement in the work of the component auditor, as well as examples of forms of involvement, are included in the application material in ISA 600.²³

Possible Actions to Address the Issues

242. In discussing the responses to address the issues, we identified the following possible actions:
- (a) Strengthening ISA 600 to provide more clarity as to how the group engagement team determines the nature, timing and extent of the necessary involvement in the work of the

¹⁷ ISA 600, paragraph 12

¹⁸ ISA 600, paragraph 24

¹⁹ ISA 600, paragraph 30

²⁰ ISA 600, paragraph 50(a)

²¹ ISA 600, paragraph 50(b)

²² ISA 600, paragraph A54; see also the connection between A54 (c) and A33.

²³ ISA 600, paragraph A55

component auditors, including more explicit focus on demonstrating why the involvement of the group engagement team is appropriate in light of all relevant considerations and the application of appropriate professional skepticism. However, due to widely varying group structures and variations in component auditors (including as it relates to their competence and expertise), ISA 600 cannot be overly prescriptive in setting forth the nature, timing and extent of appropriate involvement of the group engagement team in the work of component auditors, nor can ISA 600 be expected to address all the different approaches that might be appropriate. For example:

- In some cases, it may be appropriate for a group engagement team to undertake site visits to meet with the component auditors and review their working papers in order to be appropriately involved in their work and effectively evaluate their findings.
 - In other circumstances, preparing group instructions and providing them to a component auditor and obtaining a memorandum from the component auditor that describes in sufficient detail the work performed based on the instructions, and the resulting findings and conclusions, may be sufficient for the group engagement team's purposes
- (b) Strengthening ISA 600, either through clarification or additions to the requirements or application material, as follows
- Emphasizing the need for greater focus and professional skepticism by the group engagement team on the significant judgments that need to be made about the nature, timing and extent of the involvement of the group engagement team in work performed by the component auditors, and the need for appropriate documentation thereof.²⁴
 - Clarifying the interrelationships between paragraphs 24, 30, A33, A47 and A54 of ISA 600, to assist auditors in better applying professional judgment in determining the nature, timing and extent of their involvement in the work of the component auditors.
 - More explicitly explaining the interactions between the group engagement team and the component auditors in varying circumstances (e.g., in different group structures or in jurisdictions where restrictions on access exist).
- (c) Providing further examples in the application material to illustrate the wide variety of circumstances that may affect the determination of the necessary nature, timing and extent of the group engagement team's involvement in the work of the component auditor. Additional examples may help distinguish the varying levels of involvement of the group engagement team that may be appropriate in different circumstances. These examples may address situations where:
- The component auditors and group engagement team are not subject to common policies and procedures.
 - The component auditors are from different jurisdictions, or are subject to dissimilar laws or regulations.
 - The professional oversight; discipline and external quality assurance; education and training; and professional organizations and standards differ between the component

²⁴ Paragraphs 8(c) and A8 of ISA 230, *Audit Documentation*, set out the documentation requirements for the significant professional judgments of the auditor in reaching their conclusions

auditor and the group engagement team.

- The language and culture of the component auditor are different from the group engagement team.
- The group engagement team also performs work at the component level.

For example, the nature of the group engagement team's involvement in the work performed by the component auditor when they are not subject to the same policies and procedures (or where there are differences in any of the previously mentioned factors) will likely need to be different, and the nature and timing of such involvement may also need to be different. Depending on the circumstances, more detailed instructions and more frequent communications between the group engagement team and component auditors may be necessary as the audit progresses.

Appendix B

Approved IAASB CAG Public Session Minutes – September 2015

The IAASB CAG discussed network-related issues in its September 2015 meeting.²⁵ Relevant parts from the approved minutes of that meeting are as follows:

SPECIFIC MATTERS RELATED TO QUALITY CONTROL

Ms. French introduced the topic, noting that the focus of the discussion would be on the three matters highlighted in Agenda Item F.1, which were the areas the IAASB had asked the Quality Control Working Group (QCWG) to further consider during its June 2015 discussions. These matters would also be discussed with the IAASB at its September 2015 meeting.

Quality Control Policies and Procedures at the Firm Level when Operating as Part of a Network of Firms

Ms. French noted that the IAASB suggested the QCWG should give further consideration to how the elements contained in ISQC 1, specifically those related to governance, should take into account the fact that some audit firms operate within a network of firms. She explained that audit firms that operate through a network of firms may share, among other things, common quality control policies and procedures and may seek to leverage the network's system of quality control and related policies and procedures in meeting the individual audit firm's responsibilities in accordance with ISQC 1. She explained that regulators and audit oversight bodies have expressed concerns about:

- Overreliance by audit firms on network-level quality control policies and procedures without an appropriate basis for doing so; and
- Inadequate consideration at the network level of the results of internal and external inspection findings of audit firms within the network, and their implications to not only the network as a whole but also the individual audit firms within the network.

Ms. French further explained that audit firms within a network, for various reasons, including jurisdictional law and regulation and risk and litigation management purposes, may not be controlled by the network entity. The extent of operational and decision-making power at the network level may be limited. As a result, she noted that establishing requirements in ISQC 1 relating to how audit firms are structured, including how audit firms may choose to operate through a network of firms, may be difficult or even inappropriate, as involvement in firms' operational matters is outside of the IAASB's mandate. For these reasons, the QCWG is of the view that it would likely not be appropriate to develop requirements within ISQC 1 or a separate "ISQC 1" like standard aimed specifically at the network entity. Rather, the QCWG is of the view that consideration should be given to additional requirements and application material in ISQC 1 for the audit firm to consider in instances where audit firms seek to place reliance on policies and procedures at the network level to meet their own ISQC 1 responsibilities.

²⁵ The discussion took place before the finalization of the ITC and the feedbacks from CAG Representatives were taken into account in drafting the issues, proposed actions and questions for respondents that were included in the ITC.

The Representatives and Observers commented as follows:

- Mr. Baumann agreed that quality control policies and procedures should be at the firm level, because the responsibility for complying with the requirements of ISQC 1 apply to individual audit firms. He added that those same principles should also apply to any other audit firms that participate in the audit. Mr. Baumann requested additional clarification as to what the QCWG was suggesting related to additional requirements and application material in ISQC 1 and its application to networks. Ms. French explained that the intent was to make the distinction between imposing requirements on the network entity versus the audit firm. If an audit firm intended on leveraging, or is leveraging, policies and procedures at the network level as a means of meeting its responsibilities under ISQC 1, ISQC 1 could include matters that the audit firm would need to consider to be able to have a basis to do so, as well as how the audit firm would be able to demonstrate that the leveraging of network quality control policies and procedures is appropriate. Mr. Baumann noted that these should be requirements in ISQC 1, rather than guidance about matters that the audit firm would need to consider. Ms. Singh agreed with Mr. Baumann.
- Mr. Stewart drew attention to the definition of a network that had been included in Agenda Item F.1, noting his view that the definition is too broad in the context of an audit firm relying on network policies and procedures in order to meet the audit firms' requirements under ISQC 1. Additionally, he added that if an audit firm wishes to rely on network policies and procedures, similar to Mr. Baumann's remarks regarding the need for ISQC 1 to contain requirements in the event an audit firm is relying on network quality control policies and procedures to meet the audit firm's responsibilities under ISQC 1, the audit firm needs to have a basis for being able to do so, and ISQC 1 should have an appropriate level of clarity as to what that basis should be.
- Ms. Molyneux noted that, while the governance community, including those charged with governance, have an interest in audit quality, this will be a difficult area on which to obtain their input. She noted that, while those charged with governance may have insight into how audit firms operate and, if applicable, the network's quality control policies and procedures, those aspects have far less relevance to those charged with governance compared to details about the individual audit that was performed. Ms. Molyneux noted further that, while she recognized that a lot of effort to create quality control policies and procedures at the network level, these were often applied differently in various jurisdictions. Mr. Dalkin noted, in the context of audits of governmental entities, that these challenges often arise as a result of the audit firm not being able to control or tell other audit firms within the network that are involved in the audit what they need to be doing to address, for instance, a specific governmental requirement relevant to the audit being performed. This becomes more problematic when public expectation would be that the systems of quality control are similar given the way firms market themselves as a network. He supported the IAASB considering these matters as part of the quality control project.
- Mr. van der Ende noted that there appears to be confusion between the application of ISQC 1 at network level and individual audit firm level. In light of his view that there is little that can be done centrally in relation to network member firms, Mr. van der Ende was not convinced that additional requirements in ISQC 1 would help in this regard. He also agreed with other comments made relating to stakeholders' expectations of consistent levels of quality control

across firms in a network in circumstances where networks are marketing and communicating as one firm, when in reality this may not be the case. However, he cautioned against IAASB actions in this area as they would be difficult to implement.

Definition of Network

IAASB's International Standards

The IAASB's Standards contain the following definitions of "network" and "network firm" in ISQC 1 and ISA 220:

Network²⁶ – A large structure:

- (i) That is aimed at cooperation, and
- (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

Network firm²⁷ – A firm or entity that belongs to a network.

IESBA Code

The IESBA Code definition of "network" or "network firm" are the same as the IAASB definitions noted above. For purposes of the application of the independence requirements of the IESBA Code indicates that firms shall conclude that a network exists when a larger structure has been formed with other firms and entities to enhance their ability to provide professional services and such larger structure possesses certain characteristics.²⁸ (Please see Appendix D). Such characteristics include whether entities within the structure share:

- common ownership, control or management (achieved by contract or other means),
- common quality control policies and procedures (which are those designed, implemented and monitored across the larger structure), or
- a significant part of professional resources.

European Union – Audit Directive

In the European Union, the Directive 2006/43/EC of the European Parliament and of the Council²⁹ contains the network definition and independence rules for network firms. The definition of the network is very similar to the ISA definition:

"Network" means the larger structure

- which is aimed at cooperation and to which a statutory auditor or an audit firm belongs; and
- which is clearly aimed at profit- or cost-sharing or shares common ownership, control or management, common quality-control policies and procedures, a common business strategy, the use of a common brand-name or a significant part of professional resources.

²⁶ Paragraph 12(l) of ISQC 1

²⁷ Paragraph 12(k) of ISQC 1

²⁸ Paragraphs 290.13 to 290.24 of the extant IESBA Code, and paragraphs R400.51-R400.54 of [Proposed restructured Code](#)

²⁹ [Directive 2006/43/EC of the European Parliament and of the Council](#)

FoF

The FoF, is an independent association of international networks established to promote consistent and high-quality standards of financial reporting and auditing practices by involving the networks with IFAC's activities in audit and assurance-related areas. Twenty-seven networks at present belong to the FoF. In terms of the definitions in the FoF Constitution, "network" means "a structure comprising network firms as defined in the IESBA Code." The FoF's membership obligations require, with respect to transnational audits, the application of ISAs, ISQC 1 and the IESBA Code amongst any relevant national standards or codes of ethics, and also the conduct of regular globally coordinated internal quality assurance reviews.

PCAOB

The United States Public Company Accounting Oversight Board (PCAOB) auditing standards do not have a definition for network.

PCAOB Auditing Standard (AS) 1205³⁰ governs situations when part of the audit is performed by other independent auditors. This standard uses the term "another independent auditor which is an associated or correspondent firm," but does not give further guidance in terms of what this means.

Network is not further described in the recent PCAOB consultation on *Proposed Amendments Relating to the Supervision of Audits Involving Other Auditors*, notwithstanding the term is used in the consultation. In the context of obtaining an understanding about the other auditor's knowledge of the relevant PCAOB and United States Securities and Exchange Commission (SEC) requirements, the discussion paper of the proposal says that sources of relevant information about other auditors may differ depending, for example, on whether the lead auditor and other auditors are affiliated with the same network of audit firms.

Further requirements:

- Quality Control Standard of the PCAOB

Paragraph 6 of Quality Control Standard 20³¹ of the PCAOB says that the system of quality control should provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign offices or by its domestic or foreign affiliates or correspondents are performed in accordance with professional standards in the United States when such standards are applicable.

- SEC Practice Section ("SECPS") Requirements

Section 1000.08(n)—Audit Firm Obligations with Respect to the Policies and Procedures of Correspondent Firms and of Other Members of International Firms or International Associations of Firms:

For SECPS member firms that are members of, correspondents with, or similarly associated with international firms or international associations of firms, seek adoption of policies and procedures by the international organization or individual foreign associated firms that are consistent with the objectives set forth in Appendix K of SECPS §1000.45³² for SEC registrants.

³⁰ AS 1205, *Part of the Audit Performed by Other Independent Auditors*

³¹ QC 20 - System of Quality Control for a CPA Firm's Accounting and Auditing Practice

³² https://pcaobus.org/Standards/QC/Pages/SECPS_1000.08_appendices.aspx

- The SEC Electronic Data Gathering, Analysis and Retrieval Filer manual on Appendix K:
6810.5 Effective January 1, 2000, AICPA³³ SEC Practice Section (“SECPS”) rules established minimum requirements for the review of SEC filings by a designated “filing reviewer” within the independent accountant’s U.S. firm or international organization knowledgeable about U.S. Generally Accepted Accounting Principles, U.S. Generally Accepted Auditing Standards, U.S. auditor independence and SEC reporting requirements. Although the SECPS no longer exists, the PCAOB has adopted the requirements of Appendix K, SECPS §1000.45 pursuant to PCAOB Rule 3400T, through its adoption of Interim Quality Control Standard 1000.08(n), which cross references SECPS § 1000.45. Prior to commencing review of initial registration statements, the staff may request confirmation that Appendix K was applied to the filing, as well as the name of the designated filing reviewer that the staff may contact with any questions concerning the application of those policies and procedures to the registration statement. The purpose of the procedure is to ensure that foreign auditors appropriately involve their designated filing reviewer prior to submission of registration statements. The staff will consider deferring the review of a registration statement where the application of the firm’s established policies and procedures to that registration statement cannot be confirmed.

³³ American Institute of Certified Public Accountants

IESBA Code of Ethics for Professional Accountants – Networks and Network Firms

- 290.13 If a firm is deemed to be a network firm, the firm shall be independent of the audit clients of the other firms within the network (unless otherwise stated in this Code). The independence requirements in this section that apply to a network firm apply to any entity, such as a consulting practice or professional law practice, that meets the definition of a network firm irrespective of whether the entity itself meets the definition of a firm.
- 290.14 To enhance their ability to provide professional services, firms frequently form larger structures with other firms and entities. Whether these larger structures create a network depends on the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct. For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, a larger structure might be such that it is aimed at co-operation and the firms share a common brand name, a common system of quality control, or significant professional resources and consequently is deemed to be a network.
- 290.15 The judgment as to whether the larger structure is a network shall 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 the entities are associated in such a way that a network exists. This judgment shall be applied consistently throughout the network.
- 290.16 Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure, it is deemed to be a network. However, the sharing of immaterial costs does not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals, or training courses, this would not in itself create a network. Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not in itself create a network.
- 290.17 Where the larger structure is aimed at cooperation and the entities within the structure share common ownership, control or management, it is deemed to be a network. This could be achieved by contract or other means.
- 290.18 Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is deemed to be a network. For this purpose, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.
- 290.19 Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is deemed to be a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not deemed to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision of a professional service.

- 290.20 Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is deemed to be a network. A common brand name includes common initials or a common name. A firm is deemed to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name, when a partner of the firm signs an audit report.
- 290.21 Even though a firm does not belong to a network and does not use a common brand name as part of its firm name, it may give the appearance that it belongs to a network if it makes reference in its stationery or promotional materials to being a member of an association of firms. Accordingly, if care is not taken in how a firm describes such memberships, a perception may be created that the firm belongs to a network.
- 290.22 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 do not belong to a larger structure aimed at co-operation and are, therefore, not network firms. Those entities shall determine how to disclose that they are not network firms when presenting themselves to outside parties.
- 290.23 Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is deemed to be a network. Professional resources include:
- Common systems that enable firms to exchange information such as client data, billing and time records;
 - Partners and staff;
 - Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements;
 - Audit methodology or audit manuals; and
 - Training courses and facilities.
- 290.24 The determination of whether the professional resources shared are significant, and therefore the firms are network firms, shall be made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would 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.