

Agenda Item 3-B Supplement 2

Possible Revision to “Network Firms” Paragraphs in Part 4A

Network Firms

R400.50 A network firm shall be independent of the audit clients of the other firms within the network as required by this Part.

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400.50 A12 The independence requirements in this Part that apply to a network firm apply to any entity that meets the definition of a network firm. It is not necessary for the entity also to meet the definition of a firm. For example, a consulting practice or professional law practice might be a network firm but not a firm.

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R400.51 When associated with a larger structure of other firms and entities, a firm shall:

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- (a) Use professional judgment to determine whether a network is created by such a larger structure;
- (b) Consider whether a reasonable and informed third party would be likely to conclude that the other firms and entities in the larger structure are associated in such a way that a network exists; and
- (c) Apply such judgment consistently throughout such a larger structure.

400.510 A1 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. ~~A larger structure is a network if it is aimed at co-operation and, for example, the firms share a common brand name, a common system of quality control, or significant professional resources. Alternatively, a larger structure might be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. However, a larger structure is a network if it is aimed at co-operation and:~~

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400.51 A1 A larger structure of firms and entities is a network if it is aimed co-operation and:

- It is clearly aimed at profit or cost sharing among the entities within the structure. (Ref: Para. 400.51 A2).
- The entities within the structure share common ownership, control or management. (Ref: Para. 400.51 A3).
- The entities within the structure share common quality control policies and procedures. (Ref: Para. 400.51 A4).
- The entities within the structure share a common business strategy. (Ref: Para. 400.51 A5).
- The entities within the structure share the use of a common brand name. (Ref: Para. 400.51 A6, 400.51 A7).
- The entities within the structure share a significant part of professional resources. (Ref: Para 400.51 A8, 400.51 A9).

In addition, other arrangements between entities within a larger structure might constitute a network.

400.51 A21 ~~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 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 jointly to provide a service or develop a product does not in itself create a network.~~

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400.51 A32 ~~Where the larger structure is aimed at co-operation and the entities within the structure share common ownership, control or management, it is a network. This could be achieved by contract or other means.~~

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400.51 A43 ~~Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is a network. For the this purpose of determining whether a network exists, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.~~

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400.51 A54 ~~Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not 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.~~

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400.51 A65 ~~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 a network. A common brand name includes common initials or a common name. A firm is 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.~~

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400.51 A76 ~~Even if a firm does not belong to a network and does not use a common brand name as part of its firm name, it might appear to belong to a network if its stationery or promotional materials refer to the firm being a member of an association of firms. Accordingly, if care is not taken in how a firm describes such membership, a perception might be created that the firm belongs to a network.~~

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400.51 A87 ~~Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is a network. Professional resources include:~~

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- Common systems that enable firms to exchange information such as client data, billing and time records.
- Partners and other personnel.
- Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements.
- Audit methodology or audit manuals.

- Training courses and facilities.

400.51 A98 Whether the shared professional resources are significant depends on the circumstances. For example:

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- The shared resources might be limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information. In such circumstances, it is unlikely that the shared resources would be significant. The same applies to a common training endeavor.
- The shared resources might involve the exchange of personnel or information, such as where personnel 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. In such circumstances, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

R400.52 If a firm or a network sells a component of its practice, and the component continues to use all or part of the firm's or network's name for a limited time, the relevant entities shall determine how to disclose that they are not network firms when presenting themselves to outside parties.

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400.52 A1 The agreement for the sale of a component of a practice might provide that, for a limited period of time, the sold component can continue to use all or part of the name of the firm or the network, even though it is no longer connected to the firm or the network. In such circumstances, while the two entities might be practicing under a common name, the facts are such that they do not belong to a larger structure aimed at cooperation. The two entities are therefore not network firms.